

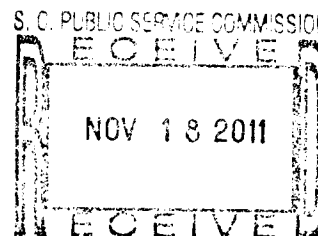
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Michael A. Molony

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November 16, 2011



**Via U.S. Mail**

Jocelyn Boyd  
South Carolina Public Service Commission  
P.O. Drawer 11649  
Columbia, SC 29211

Re: Kiawah Property Owners Group, Inc., Expert Witness Pre-Filed Testimony  
PSC Docket No. 2011-317-W/S  
YCR File No: 2589-20110772

Dear Jocelyn:

Enclosed please find Kiawah Island Property Owner's Group Inc. pre-filed expert witness testimony in the above referenced case.

I am providing a Certificate of Service, indicating all parties of record have been provided these pre-filed testimonies.

With kind regards, I am

Sincerely,

Young Clement Rivers, LLP

Michael A. Molony

MAM/jrh

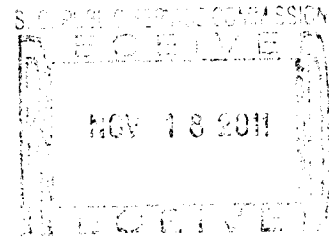
Enclosure(s)

cc: G. Trenholm Walker, Esq.  
Jeffrey M. Nelson, Esq. (ORS)  
Shannon Bowyer Hudson, Esq. (ORS)  
John P. Seibels, Jr. Esq. (KICA)  
Jason Luck, Esq. (KICA)  
Wendy Kulick  
Diane Lehder

RETURN DATE: 01/10/12  
SERVICE: 01/10/12

BEFORE THE  
PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA

Docket No. 2011-317-W/S



CERTIFICATE OF MAILING

We hereby certify that on this 16<sup>th</sup> day of November 2011, we served a copy of the foregoing  
Expert Pre-filed Testimony of Intervenor Kiawah Property Owners Group, Inc. upon:

G. Trenholm Walker, Esquire  
Pratt-Thomas, Pearce, Epting, & Walker  
P.O. Drawer 22247  
Charleston, South Carolina 29413-2227

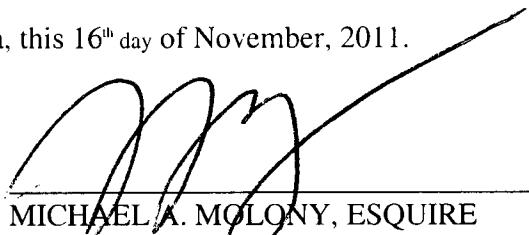
Shannon Bowyer Hudson, Esquire  
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John P. Seibels, Jr. Esquire  
Kiawah Island Community Association,  
Incorporated  
The Seibels Law Firm  
127 King Street, Suite 100  
Charleston, SC 29401

by first-class mail, postage prepaid.

DATED at Charleston, South Carolina, this 16<sup>th</sup> day of November, 2011.



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MICHAEL A. MOLONY, ESQUIRE  
Young Clement Rivers, LLP  
25 Calhoun Street, P.O. Box 993  
Charleston, South Carolina 29401

Charleston, South Carolina

1 **KIAWAH ISLAND UTILITY, INC.**

2 **DOCKET NO. 2011-317-WS**

3 **PRE-FILED TESTIMONY OF ELLEN BLUMENTHAL**

4 **BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

5 **Testimony Prepared: November 16, 2011**

6 **Hearing Date: November 30, 2011**

7  
8  
9  
10  
11  
12 **THIS TESTIMONY IS FILED PURSUANT TO PSC LETTER DATED AUGUST**  
13 **15, 2011. THE INTERVENOR RESERVES THE RIGHT TO PROVIDE**  
14 **ADDITIONAL TESTIMONY CONCERNING FURTHER INTERROGATORY**  
15 **RESPONSES AND REBUTTAL TESTIMONY TO BE PRE-FILED PURSUANT**  
16 **TO SAID ORDER, BY THE APPLICANT AND/OR ANY OTHER PARTY TO**  
17 **THIS PROCEEDING.**

18 **MR. MOLONY: PLEASE STATE YOUR NAME, EMPLOYER AND**  
19 **BUSINESS ADDRESS.**

20 **MS. BLUMENTHAL:** My name is Ellen Blumenthal and I am employed by GDS  
21 Associates, Inc. ("GDS"), a utility consulting and engineering firm with its principal  
22 offices in Marietta, GA. I am a Principal in the Firm. My business address is 13517  
23 Queen Johanna Court, Corpus Christi, Texas 78418.

1 **MR. MOLONY: PLEASE SUMMARIZE YOUR EDUCATIONAL**  
2 **BACKGROUND.**

3 **MS. BLUMENTHAL** I received a Bachelor of Arts degree in Journalism from  
4 the University of Texas at Austin in 1974, but remained at the University to do  
5 additional course work in accounting and business. I became a Certified Public  
6 Accountant in Texas in 1977.

7 **MR. MOLONY: PLEASE SUMMARIZE YOUR PROFESSIONAL**  
8 **EXPERIENCE.**

9 **MS. BLUMENTHAL:** From 1975 to 1977, I worked in public accounting. My  
10 public accounting experience included the preparation of financial statements, tax work,  
11 and auditing. In May 1977, I became a regulatory accountant with the Public Utility  
12 Commission of Texas. I left the Public Utility Commission of Texas in November 1980  
13 to open an office in Austin for C.H. Guernsey & Company, Consulting Architects and  
14 Engineers. I became an independent consultant in 1982 and joined GDS in 2002. A  
15 copy of my résumé is included in **Appendix A.**

16 **MR. MOLONY: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY**  
17 **BEFORE REGULATORY COMMISSIONS AND/OR OTHER AGENCIES?**

18 **MS. BLUMENTHAL:** Yes. I have presented testimony before the Public Utility  
19 Commission of Texas, the Texas Railroad Commission, the Kansas Public Service  
20 Commission, the Oregon Public Utility Commission, the New Mexico Public Service

1 Commission, and the Federal Energy Regulatory Commission. Please see my résumé  
2 for a more detailed listing of the regulatory bodies before which I have appeared as an  
3 expert witness.

4 **MR. MOLONY: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
5 **MATTER?**

6 **MS. BLUMENTHAL:** I have been asked to review the rate increase application of  
7 Kiawah Island Utility (“KIU”) as submitted and to render a professional opinion on  
8 certain aspects of the filing and the past actions of KIU. I discuss certain related party  
9 transactions, capital contribution issues, income tax expense, and accumulated deferred  
10 income taxes.

11 **MR. MOLONY: HAVE YOU PREVIOUSLY TESTIFIED ON SUCH MATTERS**  
12 **BEFORE OTHER REGULATORY COMMISSIONS? -**

13 **MS. BLUMENTHAL:** Yes, I have.

14 **MR. MOLONY: HAVE YOU REVIEWED THE FILING OF KIU IN THIS**  
15 **MATTER AND THE PRE-FILED DIRECT TESTIMONY OF KIU’S**  
16 **WITNESSES?**

17 **MS. BLUMENTHAL:** Yes I have.

1 MR. MOLONY: MR. GUASTELLA STATES IN HIS TESTIMONY THAT  
2 THE MANAGEMENT FEE KIU PAYS TO ITS PARENT IS ROUTINE. DO  
3 YOU AGREE?

4 MS. BLUMENTHAL: No. Transactions between related parties cannot be  
5 considered routine. In fact, transactions between affiliates require greater scrutiny  
6 because of the possibility of self-dealing. In its final order in KIU's last rate case,  
7 Docket No. 2001-164-W/S, the Commission relied upon the South Carolina Supreme  
8 Court decision in *Hilton Head Plantation Utilities v The Public Service Commission of*  
9 *South Carolina* for its decision to disallow a portion of the Kiawah Resort Associates,  
10 LP ("KRA") management fee. The standard in South Carolina as enunciated by the  
11 state's Supreme Court and included in the Commission's final order, is "charges arising  
12 out of intercompany relationships between affiliated companies should be scrutinized  
13 with care, and if there is an absence of data and information from which the  
14 reasonableness and propriety of the services rendered and the reasonable cost of  
15 rendering such services cannot be ascertained by the Commission, allowance is properly  
16 refused."

17 In setting utility rates, affiliate costs should be presumed to be unreasonable and  
18 excluded from the determination of rates and only the amounts that the utility  
19 demonstrates are reasonable and necessary should be included.

1 **MR. MOLONY: WHAT AFFILIATE TRANSACTIONS ARE INCLUDED IN**  
2 **KIU'S REVENUE REQUIREMENT?**

3 **MS. BLUMENTHAL:** In August 2005, KIU purchased sewer lines from its parent,  
4 KRA. In 2008, 2009, and 2010, KIU purchased land from its parent, KRA. According  
5 to the Company's audited financial statements, the price for the land was fair market  
6 value. However, KIU has provided no support for the assets it purchased or for the price  
7 it paid.

8 **MR. MOLONY: KIU'S PARENT COMPANY IS A LAND DEVELOPER.**  
9 **WHAT ISSUES DOES THIS RAISE WITH REGARD TO THE EVALUATION**  
10 **OF ITS WHOLLY OWNED UTILITY'S RATES?**

11 **MS. BLUMENTHAL:** My concern is that KRA appears to operate the utility in a  
12 manner that benefits its business as a developer rather than operating KIU as a regulated  
13 public utility. I am also concerned that much of the risk of the developer is being  
14 transferred to the utility. In the water and wastewater utility business, developers  
15 typically install the necessary utility system infrastructure in the process of installing  
16 streets, curbs and gutters. The availability of water and wastewater utility systems  
17 makes the developed land more marketable thereby increasing the land value. The  
18 developer recoups these costs when it sells the developed lots. These utility assets and  
19 easements are then contributed to the utility. In fact, KRA acknowledges the

1 enhancement to the value of its property in the agreement it entered into with KIU in  
2 July 1994

3 [See Exhibit 1(EB-1)]:

4 KIU has long supplied KRA with the water and sewer needs and  
5 capacities necessary to allow KRA to develop the Property to its  
6 current state and KIU's continued supply of sufficient water and  
7 sewer capacity for future development of the Property is essential to  
8 the value of the undeveloped portion of the Property.<sup>1</sup>

9 This Utility Service Agreement ("Agreement") also explicitly states "KIU will not...  
10 enter into any agreement, arrangement or contract whereby any other entity, property or  
11 project will have a greater priority than KRA or the Property with respect to the supply  
12 of water distribution and/or waste water collection and treatment."<sup>2</sup>

13 **MR. MOLONY: ARE THERE AMOUNTS INCLUDED IN KIU'S WATER AND**  
14 **WASTEWATER REVENUE REQUIREMENTS THAT ARE THE RESULT OF**  
15 **TRANSACTIONS BETWEEN KRA AND KIU?**

16 **MS. BLUMENTHAL:** Yes. In 2008, 2009 and 2010, KRA sold land to KIU at fair  
17 market value. Note 12(c) to KIU's 2010 audited financial statements states:

18 The Utility purchased land parcels from the parent company at a fair  
19 market price of \$2,000,000 and \$1,800,000 during the years  
20 December 31, 2010 and 2009, respectively.

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<sup>1</sup> Utility Service Agreement dated July 29, 1994 at 2.

<sup>2</sup> Id at 4.



1 KIU entered into a land lease arrangement with KRA in July 1995 for 2.3 acres of land  
2 to be used for storage lagoons. Note 13 to KIU's 2010 audited financial statements  
3 explains the \$1.8 million transaction further:

4 The lease term, including renewal options, covered 15 years  
5 commencing July 1, 1995, and ending on June 30, 2010. Rental  
6 expense includes \$32,289 incurred under this lease for the year  
7 ended December 31, 2009. On April 28, 2009, this lease was  
8 terminated as the Utility purchased the tract of land from its parent  
9 for \$1,800,000, the appraised value at the time.

10 Note I to the 2008 audited financial statements discloses another purchase by  
11 KIU of land it had been leasing from KRA since January 1996 for a one-million gallon  
12 potable water storage tank:

13 The lease term, including renewal options, covers 15 years  
14 commencing January 1, 1996, and ending December 31, 2010.  
15 Rental expense includes \$23,265 and \$26,823 incurred under this  
16 lease for the years ended December 31, 2008 and 2007, respectively.  
17 On October 14, 2008 this lease was terminated, as the Utility  
18 purchased the tract of land from its parent for \$1,360,000, the  
19 appraised value at the time.

20 Finally, in 2005, KRA sold sewer lines to KIU at a cost of \$382,666 rather than  
21 contributing them, as is customary in the industry. In my opinion, this would not have  
22 occurred were KIU an independent utility, rather than a developer owned one.

23 **MR. MOLONY: HOW MUCH HAVE KIU'S CUSTOMERS PAID KRA TO**  
24 **LEASE THE TWO PROPERTIES THAT ARE NOW INCLUDED IN KIU'S**  
25 **RATE BASE FOR \$1.360 MILLION AND \$1.8 MILLION?**

1 **MS. BLUMENTHAL:** KIU customers paid nearly \$780,000 in lease payments for the  
2 2.3 acre storage lagoon during the nine years 2000 through 2009. This lease  
3 commenced in July 1995. The total paid for the lease term is probably in excess of \$1  
4 million.

5 KIU customers paid approximately \$219,000 in lease payments on the land for  
6 the potable water storage during the years 2000 through 2008. This lease commenced in  
7 January 1995. The total paid for the lease term is probably in excess of \$325,000.

8 **MR. MOLONY: DOES THE UTILITY SERVICE AGREEMENT DESCRIBE**  
9 **KRA'S RESPONSIBILITIES WITH REGARD TO WATER AND**  
10 **WASTEWATER UTILITY EASEMENTS AND INFRASTRUCTURE?**

11 Yes. The Agreement states that "...KRA will reserve easements for the construction  
12 and maintenance of water and sewer (the Infrastructure) required for the supplying of the  
13 Requirements to the particular Lot or Parcels being sold and all remaining portion of the  
14 Property." (p.4, pp 4)

15 Furthermore, the Agreements states that "KRA, "at its sole cost and expense," will  
16 construct the infrastructure necessary for its development on Kiawah Island."<sup>3</sup> The USA  
17 does not stipulate that KIU will then have to purchase the infrastructure from KRA.

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<sup>3</sup> Id at 5.

1 MR. MOLONY: WHAT ARE YOUR RECOMMENDATIONS WITH  
2 RESPECT TO THE LAND PURCHASES?

3 MS. BLUMENTHAL: I recommend that the amounts paid by KIU to its parent for  
4 these assets be removed from the water and wastewater rate bases. The original cost of  
5 the water utility's plant in service should be reduced by \$3,360,000 and the original cost  
6 of the wastewater utility's plant in service should be reduced by \$2,182,666. These  
7 amounts are calculated as follows:

	Water	Wastewater
2005	\$ -	\$ 382,666
2008	1,360,000	-
2009	-	1,800,000
2010	2,000,000	-
	<u>\$ 3,360,000</u>	<u>\$ 2,182,666</u>

8 MR. MOLONY: ARE THERE OPERATING EXPENSES ASSOCIATED  
9 WITH THESE PURCHASES THAT SHOULD ALSO BE REMOVED FROM  
10 THE REVENUE REQUIREMENT?

11 MS. BLUMENTHAL: Land is not depreciable, so no adjustment to depreciation  
12 expense or accumulated depreciation is required. However, the sewer lines purchased  
13 by KIU from KRA are depreciable. The depreciation or amortization expense and the  
14 accumulated depreciation related to these lines should be removed from the calculation  
15 of the wastewater system's revenue requirement.

1           If the Commission determines KIU's allowed return using an operating margin  
2   approach, any interest expense associated with all of the purchases should be removed.  
3   According to Schedule A-2 in the Company's application, KIU's interest expense  
4   increased significantly in 2009 and 2010. Given the low interest rates that have been in  
5   place during the past few years, this increase likely reflects these land purchases.

6   **MR. MOLONY:   HAVE YOU ESTIMATED WHAT THESE AMOUNTS**  
7   **WOULD BE?**

8   **MS. BLUMENTHAL:** Yes. Depreciation and amortization expense for 2010 related  
9   to the sewer line would be approximately \$8,415 (\$382,666 times 2.199%). The  
10   accumulated depreciation would be approximately \$46,282, assuming no accumulated  
11   depreciation existed at the time the lines were purchased from KRA.

12           The interest expense related to these purchases is difficult to estimate because the  
13   purchases have taken place at various points in time. The recommendation of KPOG  
14   and its experts vis-à-vis the Rate of Return is based on the traditional utility approach of  
15   Rate of Return on Rate Base. Therefore, identification of the appropriate amount of  
16   interest is unnecessary since the interest is equal to the weighted average cost of debt  
17   times the rate base. By removing the assets from the rate base, the interest is  
18   automatically adjusted. However, if the Commission determines that KIU's equity  
19   return should be based on operating margin, interest expense should be reduced, based  
20   on the interest in the test year associated with the purchased assets.

1 **MR. MOLONY: ARE YOU RECOMMENDING THAT PROPERTY TAXES**  
2 **ALSO BE ADJUSTED TO REFLECT THE REMOVAL OF THE COST OF**  
3 **THESE ASSETS?**

4 **MS. BLUMENTHAL:** No. Taxing authorities generally do not concern themselves  
5 with how the utility acquired the property it owns. Therefore, the utility will pay  
6 property taxes on all of its assets including those that are contributed to it by developers,  
7 customers, and others.

8 **MR. MOLONY: ARE YOU AWARE THAT THE COMMISSION**  
9 **CONSIDERED THE ISSUE OF RELATED PARTY TRANSACTIONS IN KIU'S**  
10 **LAST RATE CASE?**

11 **MS. BLUMENTHAL:** Yes I am. As I have previously mentioned, the Commission  
12 disallowed a portion of the KRA management fee in KIU's last rate case. The  
13 Commission briefly addressed the testimony presented by the intervenor witnesses  
14 regarding affiliate transactions. I have read the order and the reasons stated in the order  
15 for rejecting the witnesses's testimony. The transactions between KRA and KIU are not  
16 at arm's length. Therefore, the utility must demonstrate that each of these transactions is  
17 reasonable and necessary and the price paid is reasonable and necessary. It is highly  
18 unlikely that KIU would have purchased the sewer lines from KRA if KRA were not its  
19 parent company and in control of KIU. If the transaction had been at arm's-length, KIU  
20 would have required the developer to donate the sewer lines. Furthermore, in virtually

1 any other circumstance, KIU would not have constructed utility infrastructure on leased  
2 parcels of land and then years later, purchased that same land at the current market  
3 value. This is simply a poor and irresponsible way to conduct business. Certainly, an  
4 independent KIU would have either purchased the land to begin with or entered into a  
5 lease purchase agreement that specified the price of the property if KIU later desired to  
6 purchase it, and that all or a portion of any lease payments would be applied to the  
7 purchase price.

8 **MR. MOLONY: DOES THE UTILITY SERVICE AGREEMENT ADDRESS**  
9 **KRA SELLING ASSETS TO KIU?**

10 **MS. BLUMENTHAL:** Yes. The Agreement specifically states “as additional  
11 consideration to KIU entering into this Agreement, KRA shall provide additional land to  
12 KIU, if required to meet the obligations hereof, at a price to be agreed upon, but not to  
13 exceed one-half the fair market value of such property at the time of transfer to KIU.”<sup>4</sup>  
14 The idea that there can be any negotiations between KRA and its wholly owned  
15 subsidiary, KIU, is ridiculous. If KIU were independent, it would certainly have  
16 reminded KRA of the terms of the Agreement and, at the very least, would have paid no  
17 more than half of the fair market value of the “purchased” assets.

18 **MR. MOLONY: HAS KRA EVER CONTRIBUTED PROPERTY TO THE**  
19 **UTILITY?**

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<sup>4</sup> Id at 5-6.

1 **MS. BLUMENTHAL:** Yes. According to the audited financial statements provided in  
2 response to KIU's response to KPOG's Interrogatory 5, KRA had contributed property  
3 with an original cost of \$12,290,601 as of December 31, 2001. KRA contributed  
4 property in 2005 valued at \$507,502 bringing the balance of contributed property to  
5 \$12,798,103. This is the balance of the contributed property as of December 31, 2010.

6 **MR. MOLONY: IS KRA OBLIGATED TO CONSTRUCT UTILITY**  
7 **INFRASTRUCTURE IN ITS NEW DEVELOPMENTS THAT KIU WILL**  
8 **SERVE?**

9 **MS. BLUMENTHAL:** Yes. The Agreement between KRA and KUI states:

10 "...KRA agrees to assist KIU from time to time in securing any  
11 necessary financing for the construction of facilities required by KIU  
12 to meet its obligations to expand and/or maintain the System and to  
13 provide the Requirements." (p. 6, pp7)

14 As KRA sell lots (the "Lots") or other parcels or tracts (collectively,  
15 the "Parcels") of land in the course of development of the Property,  
16 to the extent reasonably required by KIU, KRA will reserve  
17 easements for the construction and maintenance of water and sewer  
18 lines (the "Infrastructure") required for the supplying of the  
19 Requirements to the particular Lot or Parcels being sold and all  
20 remaining portions of the Property. KRA, at its sole cost and  
21 expense, shall construct the Infrastructure to the extent necessary to  
22 supply the Requirements... Additionally, KRA shall, at times  
23 convenient to its normal development process, transfer the  
24 Infrastructure and all related easements to KIU at no cost." (p.5, pp  
25 4)

26 **MR. MOLONY: WHY IS IT IMPORTANT TO DISTINGUISH THE PLANT**  
27 **THAT IS CURRENTLY PROVIDING WATER AND WASTEWATER SERVICE**

1 FROM PLANT THAT IS EITHER PLANNED FOR THE FUTURE OR IS  
2 CURRENTLY UNDER CONSTRUCTION?

3 MS. BLUMENTHAL: When rates are set, only the plant that is currently used and  
4 useful in providing service to existing customers should be included in the utility's rate  
5 base upon which the allowed return is calculated. Plant required to serve customers in  
6 new developments should not be paid for by existing customers. This is poor  
7 ratemaking and results in unjust and unreasonable rates.

8 MR. MOLONY: HOW CAN UNJUST AND UNREASONABLE RATES BE  
9 AVOIDED?

10 MS. BLUMENTHAL: Few water and wastewater utilities can afford to invest in assets  
11 upon which they cannot earn a return until sometime in the future when a new  
12 development is built out and sold out. If the utility decides to invest in infrastructure to  
13 serve new customers sometime in the future, it has to figure out how to finance the  
14 construction without harming the utility and its existing customers. As I discussed  
15 previously, developers usually install the water and wastewater infrastructure and donate  
16 it to the utility. Water and wastewater utilities will not and should not assume the  
17 developer's risk related to installing infrastructure today in the hope that it will  
18 eventually serve water and wastewater customers.

19 MR. MOLONY: WHAT ARE IMPACT FEES?



1 **MS. BLUMENTHAL:** Impact fees are fees paid to reserve capacity on a water and/or  
2 wastewater system. A utility may build a wastewater treatment facility that has more  
3 capacity than is currently needed to serve existing customers. The utility will charge an  
4 impact fee which reserves capacity for the entity that pays the fee.

5 **MR. MOLONY: WHY ARE IMPACT FEES AN IMPORTANT COMPONENT**  
6 **OF A UTILITY'S TARIFFS?**

7 **MS. BLUMENTHAL:** Impact fees help prevent intergenerational inequities. KIU  
8 charges tap fees, but does not charge impact fees. Consequently, KIU expects its  
9 existing customers to pay for the infrastructure that *may* someday serve additional  
10 customers, which is driving the significant rate increase KIU proposes in this case.

11 **MR. MOLONY: HAS KRA PAID IMPACT FEES TO THE SEABROOK**  
12 **ISLAND UTILITY COMMISSION?**

13 **MS. BLUMENTHAL:** It is my understanding that KRA contributed \$2.13 million of  
14 wastewater collection system assets to Seabrook Island Utility Commission ("SIUC") as  
15 a contribution in aid of construction related to its Cassique (residential) and Freshfields  
16 (commercial) developments. According to publicly available information, KRA also  
17 paid SIUC impact fees which SIUC assesses for each equivalent residential unit or ERU.  
18 The fee per ERU was approximately \$2,000. The \$2,000 was calculated by dividing the  
19 total capital costs by the number of equivalent residential units the new infrastructure  
20 would serve. A different formula was used for the commercial development in

1 Freshfields Village. The formula was based on the number of chairs, each of which is  
2 assumed to use approximately 40 gallons of water per day. The formula also included  
3 the number of showerheads and other commercial uses. A contract was negotiated  
4 between SIUC and KRA for the impact fees based on the results of these formulas.  
5 From April 11, 2000 through 2009, SIUC collected \$325,000 in impact fees and \$35,000  
6 in connection fees from KRA for the Cassique Project. Between 2005 and 2009,  
7 \$218,000 in impact fees and \$28,000 in connection fees were paid for approximately  
8 190 ERUs for the Freshfields project.

9 **MR. MOLONY: HOW WOULD THE COMMISSION DETERMINE WHAT AN**  
10 **APPROPRIATE IMPACT FEE SHOULD BE IN THIS CASE?**

11 **MS. BLUMENTHAL:** The Commission could require KIU to provide an analysis of  
12 the cost of extending water and sewer infrastructure to new developments to determine  
13 the appropriate impact fee per ERU. In the alternative, the impact fee that KRA paid to  
14 the Seabrook Island Utility Commission ("SIUC") would be a good benchmark for an  
15 impact fee.

16 **MR. MOLONY: WHY SHOULD IMPACT FEES BE IMPOSED IN THIS CASE?**

17 **MS. BLUMENTHAL:** Current customers should not pay for the infrastructure  
18 required to serve a new development. KIU's tariffs should include both impact fees and  
19 connection fees.

20 **MR. MOLONY: WHAT WOULD BE AN APPROPRIATE IMPACT FEE?**

1 **MS. BLUMENTHAL:** The impact fee should be based upon the estimated capital cost  
2 of the new infrastructure required to provide the upstream water and sewer capacity  
3 necessary to serve the new developments. The Commission should require KIU to  
4 include an impact fee tariff in which a formula is defined for the calculation of the fee.  
5 The fee calculated pursuant to this formula between KRA and KIU should be reviewed  
6 by the parties to this case since any agreement between KRA and KIU is not an arms-  
7 length transaction. The impact fee tariff could also include a minimum fee amount of  
8 \$2,000 per ERU for water and \$2,000 per ERU for wastewater.

9 **MR. MOLONY: DO YOU THINK THE COSTS OF THE ADDITIONAL**  
10 **WATER LINE SHOULD BE ABSORBED BY THE DEVELOPER, AND IF SO,**  
11 **WHY?**

12 **MS. BLUMENTHAL:** Yes. KRA is obligated to provide this infrastructure according  
13 to the Agreement between KRA and KIU, which is quoted above. As Ms. Diane Lehder  
14 states in her testimony, the Kiawah Property Owners Group supports the addition of the  
15 second water line, but does not believe the present customers should be required to pay  
16 for all of the cost for it. Both the Agreement as well as sound ratemaking support  
17 KPOG's position that current customers should **not** be required to pay for all of the cost  
18 of this line. KRA should build the line and transfer it to KIU to operate and maintain, or  
19 at the very least some cost sharing arrangement should be developed where some

1 portion of the line is recovered from rate payers and a portion, perhaps the larger portion  
2 is recovered through impact fees or through an up-front contribution by KRA.

3 **MR. MOLONY: HAS KIU INCLUDED ACCUMULATED DEFERRED**  
4 **INCOME TAXES (“ADIT”) IN ITS RATE BASE?**

5 **MS. BLUMENTHAL:** No.

6 **MR. MOLONY: SHOULD ADIT BE INCLUDED IN RATE BASE?**

7 **MS. BLUMENTHAL:** Yes. KIU is a public utility that takes a deduction for  
8 depreciation using accelerated tax depreciation methods. For ratemaking, the deduction  
9 for depreciation in the income tax calculation is equal to the straight-line book  
10 depreciation expense included in rates. Consequently, ratepayers are prepaying KIU’s  
11 future income tax expenses – those that will come due when straight-line depreciation  
12 exceeds accelerated tax depreciation. As such, ADIT represents cost-free capital and  
13 reduces the utility’s total rate base or invested capital.

14 **MR. MOLONY: IS KIU SUBJECT TO THE NORMALIZATION**  
15 **REQUIREMENTS OF THE INTERNAL REVENUE CODE (“IRC”)?**

16 **MS. BLUMENTHAL:** Yes. A regulated utility that uses accelerated tax depreciation  
17 is required to normalize method and life differences. Former IRC §167(l) and §46(f). In  
18 essence, ratepayers cannot be given the benefit of rapid tax depreciation. When utility  
19 rates are set, the federal income tax expense included in rates must be calculated using  
20 straight-line depreciation for the depreciation deduction (book basis and book useful

1 life), not the accelerated tax depreciation deduction actually taken on the utility's federal  
2 tax return.

3 Utilities defer the tax difference between regulatory book and tax depreciation.  
4 The current provision is accounted for in an income statement account. The other side  
5 of the entry is included in a balance sheet account, accumulated deferred income taxes.  
6 The accumulated deferred taxes will have a credit balance, signifying an account  
7 payable, during the period that accelerated tax depreciation is greater than book  
8 depreciation. This credit balance recognizes two things. It recognizes that at some point  
9 in the future, the accelerated tax depreciation will be less than the straight-line book  
10 depreciation and that the utility will owe more tax to the federal government because its  
11 tax depreciation deduction will be less. It also recognizes that ratepayers have provided  
12 the utility with these tax dollars that will be due sometime in the future. Accumulated  
13 deferred income taxes are deducted from rate base because these are dollars provided by  
14 ratepayers that represent cost-free capital to the utility until such time as the tax becomes  
15 due and payable to the federal government.

16 **MR. MOLONY: WHAT AMOUNT OF ADIT HAVE YOU INCLUDED IN RATE**  
17 **BASE?**

18 **MS. BLUMENTHAL:** The balance of ADIT payable at December 31, 2010 was  
19 \$909,413 according to KIU's audited financial statements. I have assigned this balance  
20 to the water utility and to the wastewater utility based on their relative balances of

1 accumulated depreciation as of December 31, 2010. The water rate base should be  
2 reduced by \$546,990 and the wastewater rate base should be reduced by \$362,423.

3 **MR. MOLONY: ARE YOU RECOMMENDING ANY FURTHER CHANGES**  
4 **TO THE RATE BASE?**

5 **MS. BLUMENTHAL:** Yes. Rate Base calculations usually include provision for  
6 capital of the Company that is tied up in the operations of the company. Thus, I  
7 recommend that Materials and Supplies, if any, Prepaid Expenses, and any Water  
8 Inventory Amounts be included in the rate base determination. Based on the Company's  
9 audited financial statements for 2010 and 2009, I recommend that \$302,632 be added to  
10 the Water System Rate Base, along with an allocation of Prepayments of \$22,546. In  
11 addition, I recommend that \$4,777 be added to the Sewer System Rate Base for  
12 Prepayments. These additions and the supporting calculations are shown on my **Exhibit**  
13 **2 (EB-2).**

14 **MR. MOLONY: DO YOU AGREE WITH STAFF'S USE OF A 35% FEDERAL**  
15 **INCOME TAX RATE TO COMPUTE KIU'S FEDERAL INCOME TAX**  
16 **EXPENSE?**

17 **MS. BLUMENTHAL:** No. The corporate federal income tax rates are graduated.  
18 Income is not taxes at 35% until a corporation has taxable income of at least \$18.33  
19 million. The tax rate on taxable income of \$10 million is 34% as follows:

	Taxable Income	Rate	Tax
First	\$ 50,000	0.15	\$ 7,500
Next	25,000	0.25	6,250
Next	25,000	0.34	8,500
Next	235,000	0.39	91,650
Next	9,665,000	0.34	3,286,100
	<u>\$ 10,000,000</u>		<u>\$ 3,400,000</u>

1 The federal tax rate that should be applied to KIU's taxable income is 34%. ORS has  
2 overstated the combined water and sewer income tax expense by approximately  
3 \$20,000.

4 **MR. MOLONY: DID YOU COMPUTE KIU'S INCOME TAX EXPENSE ON**  
5 **THE EQUITY RETURN KPOG AND ITS EXPERTS ARE RECOMMENDING?**

6 **MS. BLUMENTHAL:** Yes. The calculations are shown on my **Exhibit 3 (EB-3)**.

7 **MR. MOLONY: WHAT IS THE IMPACT OF YOUR RECOMMENDATIONS?**

8 **MS. BLUMENTHAL:** I have recalculated KIU's water and wastewater revenue  
9 requirements based on my recommendations on **Exhibit 4 (EB-4)**.

10 **MR. MOLONY: DOES THIS CONCLUDE YOUR TESTIMONY?**

11 **MS. BLUMENTHAL:** Yes, it does.

12 **END OF DIRECT TESTIMONY**

13

1                    **LIST OF EXHIBITS TO ACCOMPANY TESTIMONY**

- 2    **Exhibit 2 (EB-1) – Utility Service Agreement between KRA and KIU**
- 3    **Exhibit 2 (EB-2)-Revised Rate Base**
- 4    **Exhibit 3 (EB-3) – Income Tax Calculation on Recommended Equity Return**
- 5    **Exhibit 4 (EB-4) – Recalculation of KIU Revenue Requirements**



## **Annex A (EB-A)**

**EDUCATION:** University of Texas at Austin  
Bachelor of Arts in Journalism, 1975  
Certified Public Accountant in Texas, February 1977

**PROFESSIONAL MEMBERSHIPS:**  
American Institute of Certified Public Accountants  
Texas Society of Certified Public Accountants

**EXPERIENCE:**

GDS Associates, Inc., March 2002 to present

Principal of GDS Associates, Inc., Engineers and Consultants, Corpus Christi, Texas. Financial analysis for natural gas and electric markets; assist consumers in acquiring power needs in the competitive markets; provide analysis in gas, electric, telephone and water utility rate increase filings and presents expert testimony in regulatory proceedings on behalf of interveners. Issues addressed in testimony include all aspects of revenue requirement determination including affiliate transactions, income taxes, and depreciation.

Independent Consultant, June 1982 to February 2002

Financial analysis for natural gas and electric markets; Provided analysis and expert witness revenue requirements testimony in gas, electric, telephone and water utility rate increase applications on behalf of interveners.

C. H. Guernsey & Co., Consulting Engineers & Architects, November 1980 - June 1982

Title: Regulatory Accountant and Financial Analyst

Duties included preparation of financial and accounting aspects of rate filings for electric cooperatives for presentation before the Public Utility Commission of Texas. Testified as an expert witness on accounting matters before the Public Utility Commission of Texas. Advised electric cooperatives on accounting and regulatory matters. Participated in review of rate increase applications of investor-owned utilities and prepared and presented expert witness testimony based on such review.

Public Utility Commission of Texas, May 1977 - November 1980

Title: Chief Accountant III

Duties included providing expert witness testimony in investor-owned and cooperative telephone, electric and water utility rate cases filed with the Commission in the following areas: Fuel and purchased power, Operation and maintenance expenses, Federal income taxes, Taxes other than federal income taxes, Affiliate transactions, Oil and gas exploration and development. Reviewed the books and business records of public utilities to determine the reasonableness of rate requests. Reviewed public utilities' implementation of fuel adjustment clause and other rate schedules to determine compliance with tariffs approved by Commission.

Sample List of Testimony Filed and Other Utility Projects:

Hughes Natural Gas Application for Rate Change, Texas Railroad Commission GUD Nos. 10083/10093 on behalf of the Applicant.

Wood County Electric Cooperative, Inc. Application for Wholesale TCOS, Texas Public Utility Commission Docket 39290 on behalf of Applicant.

CenterPoint Energy Houston Application for Rate Change, Texas Public Utility Commission Docket 38339 on behalf of the City of Houston and Coalition of Cities.

Avista Corporation Application for Rate Change, Washington Corporation Commission Dockets UE100467 & UG 100468 on behalf of the Industrial Customers of Northwest Utilities (case settled, no testimony filed)

Portland General Electric Application for Deferred Accounting, Oregon Public Utility Commission Docket UM 1462 on behalf of the Industrial Customers of Northwest Utilities

Pacific Power & Light SB 408 Annual Income Tax Reconciliation, Oregon Public Utility Commission Docket UE 177 on behalf of the Industrial Customers of Northwest Utilities.

Portland General Electric SB 408 Annual Income Tax Reconciliation, Oregon Public Utility Commission Docket UE 178 on behalf of the Industrial Customers of Northwest Utilities.

Pacific Power & Light Request for a General Rate Revision, Oregon Public Utility Commission Docket No. UE 210 on behalf of the Industrial Customers of Northwest Utilities and the Citizens Utility Board of Oregon.

Avista Natural Gas Application for a General Rate Revision, Oregon Public Utility Commission Docket No. UG-183 on behalf of the Northwest Industrial Gas Users & the Citizens Utility Board of Oregon.

Application of Oncor Electric Delivery Company LLC for Authority to Change Rates, Texas Public Utility Commission Docket No. 35717, November 2008.

Advise Nebraska Public Service Commission on gas utility regulatory matters, 2003 to 2010.

Petition of PNM Resources, Inc. and Cap Rock Energy Corporation Regarding Merger and Acquisition of Stock, Texas Public Utility Commission Docket No. 35640, June 2008.

Application of Entergy Gulf States for Authority to Change Rates, Texas Public Utility Commission Docket No. 34800, April 2008.

Pacific Power & Light (dba PacifiCorp) to File Tariffs Establishing Automatic Adjustment Clause under the Terms of SB 408 on behalf of the Industrial Customers of Northwest Utilities, Public Utility Commission of Oregon Docket No. UE 177, January 22, 2008.

Petition by New Mexico Utilities, Inc. for Authority to Amend Its Wastewater Rates, New Mexico Public Regulation Commission Case No. 07-00435-UT, November 2007.

United Water Connecticut, Inc. Application to Change Rates, Prepare rate filing and testimony. Connecticut Department of Public Utilities Docket No. 07-05-44, June 2007.

Application of AEP Texas Central Company for Authority to Change Rates, Texas Public Utility Commission Docket No. 33309, March 2007.

Application of AEP Texas North Company for Authority to Change Rates, Texas Public Utility Commission Docket No. 33310, March 2007.

Staff's Petition for a Reallocation of Stranded Costs Pursuant to PURA Sec. 139.253(f), Texas PUC Docket No. 32795, August 2006.

Application of Bryan Texas Utilities for Interim Update of Wholesale Transmission Rates Pursuant to Substantive Rule 25.192(g)(1), Texas Public Utility Commission Docket No. 30925, March 2005; Docket No. 32958, June 2006.

Application of AEP Texas Central Company for a Financing Order, Texas Public Utility Commission Docket No. 32475, April 2006.

Application of Texas-New Mexico Power Company to Establish a Competition Transition Charge Pursuant to P.U.C. SUBST. R. 25.263(n), Texas Public Utility Commission Docket No. 31994, March 2006.

Application of the Electric Reliability Council of Texas for Approval of the ERCOT System Administration Fee, Texas Public Utility Commission Docket No. 31824, January 2006.

Application of Entergy Gulf States, Inc. for Recovery of Transition to Competition Costs, Texas Public Utility Commission Docket No. 31544, January 2006.

Application of Sharyland Utilities, L.P. for Interim Update of Wholesale Transmission Rates Pursuant to Substantive Rule 25.192(g)(1), Texas Public Utility Commission Docket No. 31826, October 2005.

Two management audits of the Sempra Energy utilities' compliance with federal and state affiliate rules. October 2005

Petition to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation, Texas Public Utility Commission Docket No. 28813 on behalf of Pioneer Energy, August 2004.

Application of CenterPoint Energy Houston Electric, LLC, Texas Genco, LP, and Reliant Energy Retail Services, LLC to Determine Stranded Costs and Other Balances, Texas PUC Docket No. 29526, on behalf of the City of Houston and the Coalition of Cities, June 2004.

Application of AEP Texas Central Company for Authority to Change Rates, Texas PUC Docket No. 28840, on behalf of the Coalition of Commercial Ratepayers, February 2004.

Application of the Electric Reliability Council of Texas to Change the ERCOT System Administrative Fee, Texas PUC Docket No. 28832, on behalf of the Office of Public Utility Counsel, January 2004.

TXU Gas Company Statement of Intent to Change Rates in the Company's Statewide Gas Utility System, Texas Railroad Commission Docket No. 9400, on behalf of Allied Coalition of Cities, December 2003.

Application of Southwestern Electric Power Company for Authority to Reconcile Fuel Costs, Texas PUC Docket No. 28045, on behalf of the Cities Served, November 2003.

Kansas Gas Service, a Division of Oneok, Inc. Application to Change Natural Gas Rates, Kansas Corporation Commission Docket 03-KGSG-602-RTS, on behalf of Unified School District No. 259, July 2003

Application of AEP Texas Central Company for Authority to Reconcile Fuel Costs, Texas PUC Docket No. 27035 on behalf of Affected Cities, April 2003.

Application of West Texas Utilities Company for Authority to Reconcile Fuel Costs, Texas PUC Docket No. 26000 on behalf of the Office of Public Utility Counsel, October 2002.

TXU Gas Distribution Application to Change Distribution Rates in its South Region on behalf of affected Texas municipalities, Fall 2002.

Application of Ernest G. Johnson, Director of the Public Utility Division, Oklahoma Corporation Commission to Review the Rates, Charges, Services and Service Terms of Oklahoma Gas & Electric Company and all Affiliated Companies and any Affiliate or Non-Affiliate Transaction Relevant to Such Inquiry, Oklahoma Corporation Commission Cause No. PUD 200100455 on behalf of the Oklahoma Attorney General, June 2002.

Petition of the Electric Reliability Council of Texas for Approval of the ERCOT Administrative Fee, Texas PUC Docket No. 23320 on behalf of Austin Energy, May 2002.

Texas-New Mexico Power Company Application for Approval of Unbundled Cost of Service Rates, Texas PUC Docket No. 22349 on behalf of the Office of Public Utility Counsel, January 2001.

TXU Lone Star Pipeline Application to Change the City Gate Rate, Texas Railroad Commission Docket No. 8976 on behalf of the Aligned Cities, January 2000.

Reliant Energy HL&P Application for Approval of Unbundled Cost of Service Rates, Texas PUC Docket No. 22355 on behalf of the City of Houston and the Coalition of Cities, December 2000.

TXU Electric Company Application for Approval of Unbundled Cost of Service Rates, Texas PUC Docket No. 22350 on behalf of the Office of Public Utility Counsel, October 2000.

Santa Fe Pipeline Partnership, L.P., FERC Docket No. OR92-8-000, *et al* on behalf of Refinery Holding Company, L.P., January 1996.

Peoples Natural Gas Company, Rate Area Three on behalf of the Nebraska Municipalities Served, December 1995.

Compliance review of Southern Union Gas Company's fuel cost recovery in the City of El Paso on behalf of the City of El Paso, Texas, Spring 1995.

Houston Lighting and Power Company, Texas PUC Docket No. 12065 on behalf of Office of Public Utility Counsel, November 1994.

El Paso Electric Company, Texas PUC Docket No. 12700 on behalf of Office of Public Utility Counsel and The City of El Paso, Texas, June 1994.

Application of Central and South West Corporation and El Paso Electric Company For Approval of Acquisition, PUC Docket No. 12700 on behalf of Office of Public Utility Counsel, June 1994.

El Paso Electric Company, Public Utility Regulation Board of The City of El Paso, Texas on behalf of the City of El Paso, Texas, May 1994.

Kansas Pipeline Partnership and Kansas Natural Partnership, Kansas Docket No. 190,362-U on behalf of Citizens' Utility Ratepayer Board, September 1994.

KN Energy, Inc., Kansas Corporation Commission Docket No. 186,363-U on behalf of Citizens' Utility Ratepayer Board, September 1993.

City of Austin Water and Wastewater Utility before City Counsel on behalf of residential and small commercial ratepayers, October 1993.

Texas Utilities Electric Company, Texas PUC Docket No. 11735 on behalf of Certain Cities Served by Texas Utilities Electric Company, September 1993.

Complaint of General Counsel against Cherokee County Electric Cooperative, Inc. regarding application of Cherokee's switchover tariff, Texas PUC Docket No. 11351, on behalf of the Cooperative, June 1993.

Texas Utilities Electric Company, Texas PUC Docket No. 11735 on behalf of the Office of Public Utility Counsel, April 1993.

Application of Entergy Corporation and GSU for Sale, Transfer or Merger, Texas PUC Docket No. 11292, on behalf of Office of Public Utility Counsel, January 1993.

Peoples Natural Gas Company, Kansas Corporation Commission Docket No. 180,416-U, on behalf of the Citizens' Utility Ratepayer Board, August 1992.

Kansas Public Service Company, Kansas Corporation Commission Docket No. 179,484-U, on behalf of the Citizens' Utility Ratepayer Board, April 1992.

Complaint of NBC Telecommunications, Inc. against Southwestern Bell Telephone Company, Texas PUC Docket No. 10762, on behalf of complainant, September 1992.  
Central Texas Telephone Company, Texas PUC Docket No. 9981, on behalf of the Office of Public Utility Counsel, December 1991.

Texas-New Mexico Power Company, Texas PUC Docket No. 10200, on behalf of the Office of Public Utility Counsel, December 1991.

Greeley Gas Company, Kansas Corporation Commission Docket No. 177,142-U, on behalf of the Citizens' Utility Ratepayers Board, November 1991.

Peoples Natural Gas Company, Rate Areas Two and Three on behalf of the Nebraska Municipalities Served, November 1991.

Southern Union Gas Company El Paso Service Area, Public Utility Regulatory Board of El Paso on behalf of the City of El Paso, November 1991.

City of Round Rock, Texas Water Commission Docket No. 8600-M, on behalf of Brushy Creek Municipal Utility District, October 1991.

El Paso Electric Company, Texas PUC Docket No. 9945, on behalf of the Office of Public Utility Counsel, April 1991.

Houston Lighting & Power Company, Texas PUC Docket No. 9850, on behalf of the Office of Public Utility Counsel, February 1991.

Greeley Gas Company, Kansas Corporation Commission Docket No. 170,588-U, on behalf of the Citizens' Utility Ratepayers Board, August 1990.

Rio Grande Valley Gas Company, Texas Railroad Commission Docket No. 7604, Consolidated, on behalf of the Intervener Cities, May 1990.

Southern Union Gas Company El Paso Service Area, Public Utility Regulatory Board of El Paso on behalf of the City of El Paso, October 1990.

Texas Utilities Electric Company, Texas PUC Docket No. 9300, on behalf of the Intervener Cities, April 1990.

Gulf States Utilities Company, Texas PUC Docket No. 8702, on behalf of the Intervener Cities, July 1989.

Central Power & Light Company, Texas PUC Docket No. 8646, on behalf of the Intervener Cities, June 1989.

Lower Colorado River Authority, Texas PUC Docket No. 8400, on behalf of several wholesale customers, February 1989.

Lower Colorado River Authority, Texas PUC Docket No. 8032, on behalf of several wholesale customers, June 1988.

Tawakoni Water Utility Corporation, Texas Water Commission Docket No. 7368-R, on behalf of Tawakoni Water Consumers Association, January 1988.

Hill Country Waterworks Company, Texas Water Commission Docket No. 172-W, on behalf of the City of Hill Country Village and the City of Hollywood Park, July 1987.

Detroit Edison Company, Michigan PSC, Case No. U-8683, on behalf of North Star Steel Michigan, May 1987.

Gulf States Utilities Company, Texas PUC Docket No. 7195, on behalf of North Star Steel Texas, January 1987.

Rio Grande Valley Gas Company, Texas Railroad Commission Docket No. 4717, 1984 and Docket No. 3858, on behalf of the Rio Grande Valley Cities, March 1982.

Lower Colorado River Authority, Texas PUC Docket No. 6027, on behalf of several wholesale customers, March 1985.

Houston Lighting and Power Company, Texas PUC Docket No. 4540, August 1982, on behalf of the City of Houston.

Houston Lighting & Power Company, Texas PUC Docket No. 3320, September 1980, on behalf of the Texas Public Utility Commission.

Inquiry by Public Utility Commission of Texas into Certain Affiliate Transactions of Texas Electric Service Company, Texas Power and Light Company and Dallas Power and Light Company, Texas PUC Docket Nos. 1517, 1813 and 1903, February 1979, on behalf of the Texas Public Utility Commission.

**Exhibit 1 (EB-1)**



STATE OF SOUTH CAROLINA                     )  
   ) UTILITY SERVICE AGREEMENT  
COUNTY OF CHARLESTON                     )

This Utility Service Agreement (this "Agreement") made and entered into this 29th day of July, 1994 by and between Kiawah Resort Associates, L.P. and Kiawah Island Utility, Inc.

W I T N E S S E T H

Kiawah Resort Associates, L.P. ("KRA") is a Delaware limited partnership which owns approximately 2,000 acres of undeveloped real property more particularly described in Exhibit A attached hereto (the "Property") located on Kiawah Island, South Carolina on which may be added several thousand housing units under current zoning authorizations, with a cap of adding 1974 such units plus extensive commercial, hotel, and mixed use under a development agreement (the "Development Agreement") about to be entered by KRA and the Town of Kiawah.

Kiawah Island Utility, Inc. ("KIU") is a South Carolina corporation which owns approximately 18 acres of real estate more generally described in Exhibit B attached hereto (the "KIU Property") located on Kiawah Island South Carolina, together with various improvements, equipment, contract rights, easements and other property rights.

KIU operates a water distribution and waste water collection and treatment system (the "System") on the KIU Property for service to persons and businesses on Kiawah Island, South Carolina.

KRA is in the process of developing the Property pursuant to its development plan (the "Development Plan") which, by its nature, is subject to change over time, and upon its execution, in accordance with the Development Agreement. KIU has long supplied KRA with the water and sewer needs and capacities necessary to allow KRA to develop the Property to its current state and KIU's continued supply of sufficient water and sewer capacity for future development of the Property is essential to the value of the undeveloped portion of the Property.

The historical relationship between KRA and KIU (with the former owning all shares of stock in the latter) has been in large part responsible for the development of Kiawah Island as a first-class residential and resort community as well as the sound financial status of KIU. The timely provision of water and sewer infrastructure and services assures that the highest values are created and maintained for all Kiawah properties. This has been possible in the past due to, among other things, the constant commitment of KRA to assist with financing of enhanced and continually expanding utilities infrastructure. A utilities agreement is deemed necessary and desirable in order to facilitate and assure the continued mutual benefits to both KRA and KIU as development of Kiawah Island continues.

To that end, KRA desires to contract with KIU to provide for the timely supply of water distribution and waste water collection and treatment with respect to the Property. KIU desires to contract with KRA to assure that future needs for expansion and improvement of its capabilities are provided for in a timely and sufficient manner. Both parties acknowledge and agree that any failure or delay by KIU in complying with the terms, conditions, and obligations set forth in this Agreement will have a material and substantial adverse impact on the value of the Property and the ability of KRA to complete the development of the Property in accordance with the Development Plan and the Development Agreement.

KRA, KIU and their respective engineers and agents have reviewed the Development Plan (relating to the commercial, rental, and mixed use parcels owned by KRA), and determined the capacities of water and waste water collection and treatment required during the various phases of development of the Property pursuant to the Development Plan. Such estimated requirements are listed on Exhibit C attached hereto and are generally referred to hereinafter collectively as the "Requirements," or, separately, as the "Water Requirements" or the "Sewer Requirements".

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NOW, THEREFORE, in consideration of the mutual promises set forth herein and other good and valuable consideration flowing to both parties, the receipt and adequacy of which are hereby acknowledged, the parties do hereby agree as follows:

1. Commencing as of the date of this Agreement and continuing for the entire term of this Agreement, KIU, its successors and assigns, shall, subject to the availability of the utility funds generated from customers according to KIU's Rate Schedule approved by the South Carolina Public Service Commission ("PSC"):

- (a) Supply KRA, its successors and assigns, with all present and future Requirements for all or any portion of the Property which is either then being or may be developed pursuant to the Development Plan, as the same may be amended from time to time by KRA;
- (b) Maintain and operate the System in accordance with all applicable Legal Requirements; and
- (c) Expand, modify, update, upfit, maintain, repair, improve and operate the System in such manner as is necessary to allow KIU to supply the Requirements provided for herein. This shall include, but not be limited to, expending such capital in a timely manner as may be necessary to expand the water delivered by the City of Charleston Commissions of Public Works ("CPW") and/or the St. John's Water District so as to serve KRA's future development of the Property.

2. So long as KIU complies with the terms of this Agreement and has the physical plant and capacity to of supply the Requirements to KRA, its successor or assigns, KRA, its successors or assigns, agrees to purchase the Requirements from KIU at the rates which are currently published by the PSC, or at such increased or decreased rates as may be approved by

the PSC from time to time. Anything to the contrary contained in the previous sentence notwithstanding, KRA may provide water to all or any portion of the Property from certain wells that KRA may establish from time to time. Further, during the term of this Agreement, KRA agrees to give KIU the right of first refusal to provide utility service to such areas off of Kiawah Island as KRA may develop from time to time, including the property known as Mullet Hall Plantation, a 1,000+ acre tract located immediately across the Kiawah River from the Property and which is planned for future development as a high-end residential golf community.

3. KIU will not (i) apply for or support any change in rates by PSC which shall be discriminatory against KRA, its successors or assigns, or any portion of the Property; or (ii) enter into any agreement, arrangement or contract whereby any other entity, property or project will have a greater priority than KRA or the Property with respect to the supply of water distribution and/or waste water collection and treatment; (iii) charge KRA any fee, exaction, or other monetary payment of any kind for provision of water and sewer services other than those approved by the PSC. KIU and KRA acknowledge that the effluent presently being produced by KIU's sewer treatment plant is a result of an aeration treatment process. In the event that subsequent to the effective date of this Agreement either: (a) any legal requirement necessitates that the treatment of waste water be increased to a higher standard with a resultant increase in the water quality of the effluent; or (b) any capital expenditures are made by KIU for purposes of receipt and handling of sewerage or the treatment and delivery of water or effluent; then in such event the cost thereof will be paid for by KIU and recovered by KIU by such permitted rate increases as are approved by the PSC.

4. As KRA sells lots (the "Lots") or other parcels or tracts (collectively, the "Parcels") of land in the course of the development of the Property, to the extent reasonably required by KIU, KRA will reserve easements for the construction and maintenance of water and

sewer lines (the "Infrastructure") required for the supplying of the Requirements to the particular Lot or Parcels being sold and all remaining portions of the Property. KRA, at its sole cost and expense, shall construct the Infrastructure to the extent necessary to supply the Requirements in accordance with reasonable engineering and construction standards, all applicable Legal Requirements, and the Development Plan.

Additionally, KRA shall, at times convenient to its normal development process, transfer the Infrastructure and all related easements to KIU at no cost. KIU shall accept such transfers and shall maintain, repair, and replace the Infrastructure in a good, professional and workmanlike manner, from time to time, to the extent necessary to supply the Requirements. KIU's obligations to accept transfer of the Infrastructure and all related easements and to maintain, repair and replace the same shall be unconditional, provided prevailing industry construction standards and typical legal requirements are met (as have been customary for the last 20 years).

5. At any time upon reaching 80% of maximum treatment capacity of the System (as then existing) required to provide the then committed Requirements (and notwithstanding actual flows or use indicators), KIU will take all steps necessary to expand said capacities in order to provide for the projected Requirements, as same may change from time to time. KRA may amend Exhibit C from time to time by submitting new or revised Development Plan and/or Requirements to KIU; provided, however, KIU shall not be required to commence new construction based on any such change(s) for three (3) months following receipt of such revisions and until adequate funds are available (unless such construction was already planned, or required under the provisions of this paragraph).

6. As additional consideration to KIU entering into this Agreement, KRA shall provide additional land to KIU, if required to meet the obligations hereof, at a price to be agreed

upon, but not to exceed one-half the fair market value of such property at the time of transfer to KIU. KRA shall have the sole discretion to select the location of any such property within the Sora Rail Road and other areas.

7. As additional consideration for the duties and obligations of KIU herein, KRA agrees to assist KIU from time to time in securing any necessary financing for the construction of facilities required by KIU to meet its obligations to expand and/or maintain the System and to provide the Requirements. This financial assistance may be in the form of loans, mortgages, letters of credit, bonds or such other type of credit enhancement as KRA in its sole discretion elects.

8. KIU agrees to satisfy all applicable Legal Requirements related to the operation or maintenance of the System and the supply of the Requirements.

9. As used herein "Legal Requirements" shall mean the requirements, approvals, consents, permits, licenses and the like which are imposed or required by all applicable laws, ordinances, rules, regulations or conditions of any federal, state, county, city or local government agency or authority, including, without limitation, the South Carolina Department of Health and Environmental Control and/or PSC.

10. The rights, covenants, obligations, duties, benefits, burdens, easements and other provisions created, declared or contained in this Agreement shall benefit the Property and bind the KIU Property, respectively, and each owner, purchaser, tenant, invitee, mortgagee, licensee, user, and lienholder of any part or such portions of the Property or of the KIU Property and each of their respective successors and assigns, and shall at all times hereafter be commercially necessary, appurtenant to, affect and run with the land (i.e., the Property or the KIU Property, respectively) generally.

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11. KRA and KIU acknowledge and agree that any failure or refusal of either party hereto, its successors or assigns, to strictly comply with the terms of this Agreement could have serious and irreparable consequences to the non-defaulting party. As a result, the non-defaulting party may elect, upon any such breach, to seek, and is hereby granted the right, to have specific performance of this Agreement as well as any other legal or equitable remedy provided by law. In the event of any litigation between KRA and KIU arising out of breach or enforcement of or merging from this Agreement, the prevailing party in such litigation (or appeal therefrom) shall be entitled to reasonable attorney's fees and all reasonable costs of such action, including the cost of expert witnesses.

12. This Agreement shall commence upon the execution hereof and shall continue in effective for a period of twenty (20) years hereafter; provided; however, that this Agreement may be terminated by either party upon the occurrence of a default by the other party in the performance of a material obligation under this Agreement which is not cured within thirty (30) days after written notice of default to such defaulting party, or, if the subject default(s) requires more than thirty (30) days to cure, if the defaulting party fails to begin performance within such thirty (30) day period and does not diligently and continuously proceed with such performance until completion.

13. All notices, elections and communications permitted or required hereunder shall be in writing, signed by the party making the same, and shall be delivered personally or by registered or certified mail, return receipt requested, to the other parties hereto at the addresses set forth below their respective signature block. The date of such notice of communication shall be the date of personal delivery or mailing as the case may be. In the event any date on which any notice or election is required to be made hereunder falls on a Saturday, Sunday, or federal

holiday, then the date on which notice is required to be given or made hereunder shall, for all purposes, be deemed to be the next following business day.

14. All rights and remedies of the parties hereunder shall be cumulative, and none shall be exclusive of any other, or of any rights and remedies allowed by law, and pursuit of any one of said rights or remedies does not preclude pursuit of any one or more of such other rights or remedies.

15. The parties shall cause this Agreement (or a memorandum of agreement evidencing this Agreement) to be recorded in the Office of the Register of Mesne Conveyances for Charleston County, South Carolina. The parties shall share any recording fees and other charges related to such recording.

16. If any term of this Agreement is declared to be illegal or unenforceable, all other terms hereto shall remain in full force and effect.

17. No covenant, term or condition hereof shall be deemed waived, except by written consent of the party against whom the waiver is claimed, and any waiver of the breach of any covenant, term or condition shall not be deemed to be a waiver of any preceding or succeeding breach of the same or any other covenant, term or condition of this Agreement. Acceptance of any performance by a party after the time the same shall have become due shall not constitute a waiver by the nondefaulting party of the breach or default of any covenant, term or condition of this Agreement unless otherwise expressly agreed to by the non-defaulting party in writing.

18. This Agreement, together with any later written modifications or amendments thereto, shall constitute the entire agreement between the parties with respect to the subject matter hereof and shall supersede any prior or contemporaneous agreements or understandings, whether written or oral, which the parties, their agents or representatives may have had relating



to the subject matter hereof. No modification, alteration or waiver of any term, condition or covenant of this Agreement shall be valid unless in writing and signed by both parties hereto.

19. This Agreement is entered into in South Carolina and shall be enforced and construed in accordance with the laws thereof.

20. Time is of the essence with respect to all obligations to be performed by the parties hereunder.

NP -00-000000000000

IN WITNESS WHEREOF, Kiawah Island Utility, Inc. and Kiawah Resort Associates, L.P. have caused these presents to be executed and their seals affixed hereto as of the date and year first written above.

## WITNESSES:

Maria Z. Lugo

Dara C. Joyner

KIAWAH RESORT ASSOCIATES, L.P., a  
Delaware Limited Partnership (SEAL)

By: D&W Investments, Inc., a South Carolina  
Corporation  
Its: General Partner

By: Charles S. Way, Jr.  
Charles S. Way, Jr.  
Its: President

By: Betty R. Crow  
Betty R. Crow  
Its: Secretary

Notice Address: 200 Meeting Street, Suite 401  
Charleston, SC 29401

Maria Z. Lugo

Dara C. Joyner

KIAWAH ISLAND UTILITY, INC., a South  
Carolina Corporation (SEAL)

By: Charles P. Darby, II  
Charles P. Darby, II  
Its: President

Notice Address: 31 Sora Rail Road  
Kiawah Island, SC 29455

STATE OF SOUTH CAROLINA )  
 )  
COUNTY OF CHARLESTON )

PROBATE

PERSONALLY appeared before me the undersigned witness after first being duly sworn, deposes and says that s/he saw the within-named KIAWAH RESORT ASSOCIATES, L.P., a Delaware limited partnership, by Charles S. Way, Jr., its President, and Betty R. Crow, its Secretary, sign, seal and as its act and deed, deliver the within-written Utility Service Agreement for the uses and purposes therein mentioned, and that s/he together with the other witness whose signatures appears above, witnessed the execution thereof.

Maria Lopez  
WITNESS

SWORN TO BEFORE ME THIS  
8th day of September, 1994.

Daria C. Jones (S.)  
Notary Public for South Carolina  
My commission expires: 10-31-2001

STATE OF SOUTH CAROLINA  
COUNTY OF CHARLESTON

)  
)  
)

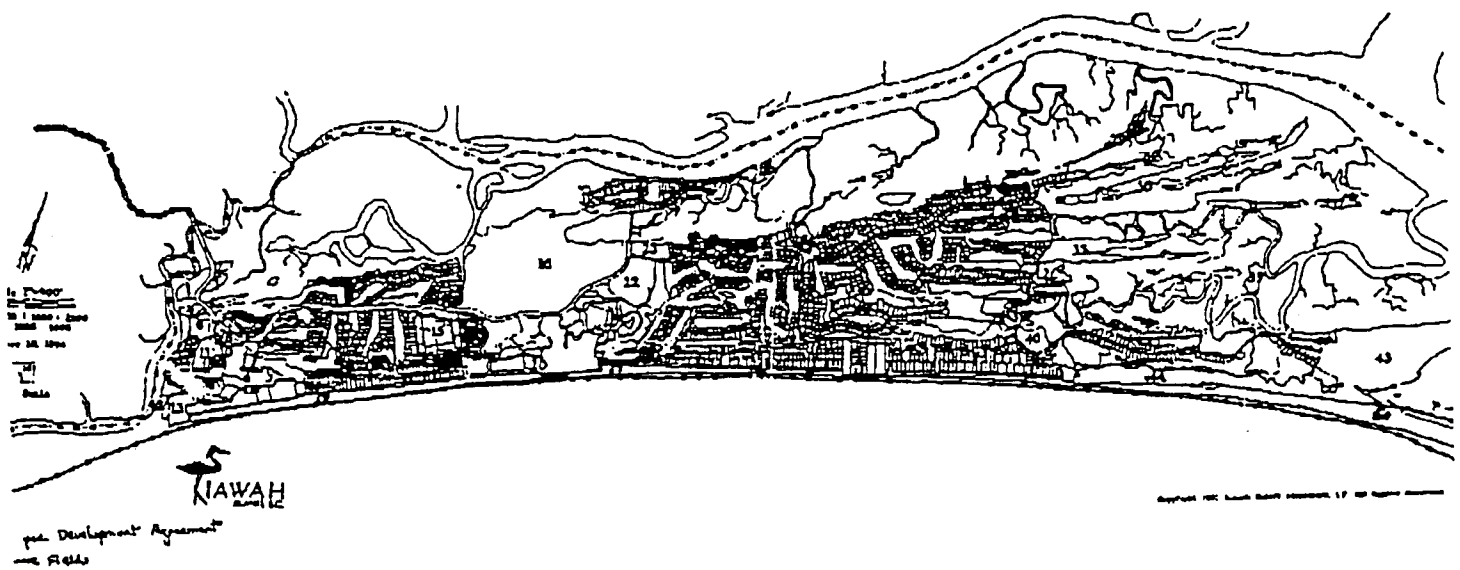
PROBATE

PERSONALLY appeared before me the undersigned witness after first being duly sworn, deposes and says that s/he saw the within-named KIAWAH ISLAND UTILITY, INC., a South Carolina corporation, by Charles P. Darby, III, its President, sign, seal and as its act and deed, deliver the within-written Utility Service Agreement for the uses and purposes therein mentioned, and that s/he together with the other witness whose signature appears above, witnessed the execution thereof.

Maria L. Gage  
WITNESS

SWORN TO BEFORE ME THIS  
8th day of Sept., 1994.

David C. Jayma (S.)  
Notary Public for South Carolina  
My commission expires: 10-31-2001



## Exhibit "B"

Description of the KIU Property

All that certain piece, parcel or tract of land with the buildings and improvements thereon, situate, lying and being on Kiawah Island, Charleston County, South Carolina, containing 16.91 acres, more or less, and lying generally south and west of Sora Rail Road and shown on a plat by Coastal Surveying Co., Inc., dated March 31, 1976, and revised September 3, 1981, entitled "Plat of Sewage Treatment Plant and Water Storage Facility Located on Kiawah Island, Charleston County, South Carolina Owned by Kiawah Island Company Limited Kiawah Island Charleston, S.C. 29455", and recorded in Plat Book AU at Page 60, in the RMC Office for Charleston County, South Carolina, and being more particularly described, according to said plat, as follows:

COMMENCING at a point marked by a concrete monument, lying on the west right-of-way line of Sora Rail Road, 1,063.48 feet from the intersection of the western right-of-way line of Sora Rail Road, as extended, with the centerline pavement of the Kiawah Island Parkway, and running thence along said western right-of-way line of Sora Rail Road and the southern extension thereof, S23°23'00"E 560.00 feet to a point marked by a concrete monument; thence cornering and running S66°37'00"W 920.00 feet to a point marked by a concrete monument; thence cornering and running N23°23'00"W 1,000.00 feet to a point marked by a concrete monument; thence cornering and running N66°37'00"E 345.00 feet to a point marked by a concrete monument; thence cornering and running S51°33'42"E 158.82 feet to a point marked by a concrete monument; thence cornering and running S23°23'00"E 160.00 feet to a point marked by a concrete monument; thence cornering and running N66°37'00"E 300.00 feet to a point marked by a concrete monument; thence cornering and running S23°23'00"E 140.00 feet to a point marked by a concrete monument; thence cornering and running S66°37'00"E 200.00 feet to a point marked by a concrete monument lying on the west right-of-way line of Sora Rail Road, said point being the point of beginning, be all the same dimensions a little more or less.

ALSO

## Parcel 2

## "Well Pump Tract"

All that certain piece, parcel or tract of land situate, lying and being in the Town of Kiawah Island, Charleston County, State of South Carolina, containing 0.063 acres, more or less, and shown on a plat by Southeastern Surveying, Inc., entitled "A BOUNDARY SURVEY OF THE WELL PUMP TRACT OWNED BY LANDMARK LAND COMPANY OF CAROLINA, INC., TO BE CONVEYED TO KIAWAH ISLAND UTILITY, INC., LOCATED IN THE TOWN OF KIAWAH ISLAND CHARLESTON COUNTY, SOUTH CAROLINA", dated April 19, 1991, as revised September 5, 1991, and recorded in Plat Book CE at Page 96, in the RMC Office for Charleston County, South Carolina (the "Plat"), said property having such location, metes, butts, bounds, courses and distances as will by reference to said plat more fully appear.

## Parcel 3

Easement for access over Sora Rail Road granted to Kiawah Island Utility, Inc. ("KUI") by Kiawah Resorts Associates (a South Carolina joint venture) ("KRA") in Grant of Easement dated April 12, 1990 and recorded in Book L-192, at Page 618 in the RMC Office for Charleston County (the "RMC").

## Parcel 4

Easements granted to KIU by Landmark in Title To Real Estate With Reservations, Restrictions, Reverters and Release dated September 6, 1991 and recorded in Book G-206, at Page 861.

## Parcel 5

Easements granted to KRA by Landmark in Grant of 30' Easement and Amendment of Easement and Beachfront Property Agreement dated July 26, 1991 and recorded in Book X-204, at Page 613 in the RMC, a portion of said easements being conveyed to KIU by KRA in Assignment of Non-Exclusive Easement dated June \_\_\_\_, 1992 and recorded in Book \_\_\_\_ at Page \_\_\_\_ in the RMC.

NP -00-0000000015

20426.1-EX (SSJ) 000000-486

NP -00-0000000016

# NAWAH RESORT ASSOCIATES, L.P. FUTURE WATER COMMITMENTS

01-Sep-94

## ASSUMPTIONS

WATER  
POTABLE WATER CONSUMPTION PER RESIDENTIAL UNIT  
IRRIGATION WATER CONSUMPTION PER RESIDENTIAL UNIT

500 GPD/AY  
300 GPD/AY  
800 GPD/AY

POTABLE WATER CONSUMPTION PER 1000 SF COMMERCIAL

500 GPD/AY

SEWER PROCESSING PER 1000 SF COMMERCIAL

200 GPD/AY

COMMERCIAL DEVELOPMENT PER ACREAGE

4,000 SF/AC

## SEWER

SEWER PROCESSING PER RESIDENTIAL UNIT

300 GPD/AY

## DEVELOPMENT

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	TOTAL
SINGLE FAMILY														
BASS POND		250												250
RHETT BLUFF			35											35
MARSH COVE SUB 405		25												25
OSPREY BEACH II		30												30
OTTER ISLAND		35												35
COUGAR ISLAND	11									120	150			270
BLUE HERON														
EAGLE POINT	51													51
FALCON POINT														
THREE LOONS														
OSPREY FINGER														
MARSH COTTAGE	14													14
CPT MATTHEWS	10													10
WILLET ISLAND														
VANDERHOOT	10													10
TOTAL SINGLE FAMILY	14	340	25	115	200	15	175	400	0	120	150	0	0	1,145
MULTI FAMILY														
OCEAN SUB 1416														
CL HOTEL #119														
GOV DRINKER PARKWAY														
OCEAN GREEN														
TOTAL MULTI FAMILY	0	0	30	35	0	0	110	0	60	60	60	0	0	345
DEVELOPED LOTS	40	58	48	28	2	1	1	1	1	7	6			223
TOTAL RESIDENTIAL UNITS	144	398	173	208	402	16	286	401	81	177	216	0	0	2,455

## UTILITY REQUIREMENTS

RESIDENTIAL	122,800	318,200	94,400	144,400	321,800	12,800	228,800	320,800	48,800	141,800	172,800	0	0	1,864,800
WATER REQUIREMENTS (GALLONS)														
SEWER REQUIREMENTS (GALLONS)	48,800	118,700	34,800	87,400	120,800	4,800	85,800	120,300	18,300	53,100	64,800	0	0	758,500
COMMERCIAL														
ACRES														
SQUARE FOOTAGE														
WATER REQUIREMENTS														
SEWER REQUIREMENTS														
TOTAL REQUIREMENTS	171,600	436,900	129,200	231,800	442,600	17,600	314,600	441,100	67,100	194,900	237,600	0	0	2,623,300
WATER REQUIREMENTS (GALLONS)														
SEWER REQUIREMENTS (GALLONS)	48,800	118,700	34,800	87,400	120,800	4,800	85,800	120,300	18,300	53,100	64,800	0	0	758,500

plus any supplemental water required for golf course spray irrigation (River Course)



**Exhibit 2 (EB-2)**

Kiawah Island Utilities, Inc.  
Combined Water & Sewer Rate Base- Phase I

	Company		Kiawah Property Owners	
	Per Books 12/31/2010	Proposed 12/31/2011	Adjustments	As Adjusted
1 Plant in service	\$ 23,276,661	\$ 23,545,879	\$ (5,542,666) (a)	\$ 18,003,213
2 Accumulated Depreciation	(8,482,751)	(8,916,827)	(408,814)	(8,870,545)
3 CWIP	2,709	2,709		
4 Net Plant	\$ 14,796,619	\$ 14,631,761	\$ (5,951,480)	\$ 9,132,668
5 Working Capital	482,070	500,795		500,795
6 Accumulated deferred income taxes			(909,413) (a)	(909,413)
7 Unamortized Bal. of Rate Case Exp.	-	169,226	-	169,226
8 Unamortized Bal. of Extraord Exp.	-	24,603	-	24,603
9 Materials and Supplies			- (b)	-
10 Water Inventory			302,632 (c)	302,632
11 Prepaid Expenses			27,324 (d)	27,324
12 Rate Base	\$ 15,278,689	\$ 15,326,385	\$ (6,530,938)	\$ 9,247,834

(a) KIU response to KPOG DR 150

Additions to Rate Base

	Materials & Supplies (b)	Inventory (c)	Prepayments (d)
13 Balance Beginning-of-year (2010)	\$0.0	\$295,690	\$26,314
14 Balance End-of-year (2010)	\$0.0	\$309,574	\$28,333
Average	\$0.0	\$302,632	\$27,324

Allocation of Additions to Water and Sewer

	Water	Sewer	Total
Operating Expenses	\$3,306,159	\$700,503	\$4,006,662
Allocation	0.82517	0.17483	1.00000
Prepayments	\$22,546	\$4,777	\$27,324
Water Inventory	\$302,632		\$302,632

Kiawah Island Utilities, Inc.  
Water Rate Base - Phase I

	Company		KPOG	
	Test Year 12/31/2010	Adjustments	Proposed	As Adjusted
1 Plant in service	\$ 13,800,427	\$ 99,209	\$ 13,899,636	\$ 10,539,636
2 Accumulated Depreciation	(5,102,169)	(256,069)	(5,358,238)	(5,358,238)
3 CWIP				
4 Net Plant	\$ 8,698,258	\$ (156,860)	\$ 8,541,398	\$ 5,181,398
5 Working Capital	397,016	16,219	413,235	413,235
6 Unamortized Bal. of Rate Case Exp.	-	84,613	84,613	84,613
7 Unamortized Bal. of Extraordinary Exp.	-	24,603	24,603	24,603
8 Accumulated deferred income taxes			(546,990)	(546,990)
9 Materials and Supplies				0
10 Water Inventory			302,632	302,632
11 Prepaid Expenses			22,546	22,546
12 Rate Base	\$ 9,095,274	\$ (31,425)	\$ 9,063,849	\$ 5,482,038

Kiawah Island Utilities, Inc.  
Sewer Rate Base - Phase I

	Company		KPOG	
	Test Year 12/31/2010	Adjustments	Pro Forma 12/31/2011	As Adjusted
1 Plant in service	\$ 9,476,234	\$ 170,009	\$ 9,646,243	\$7,463,577
2 Accumulated Depreciation	(3,380,582)	(178,007)	(3,558,589)	(3,512,307)
3 CWIP	2,709	0	2,709	
4 Net Plant	\$ 6,098,361	\$ (7,998)	\$ 6,090,363	\$ 3,951,270
5 Working Capital	85,054	2,506	87,560	87,560
6 Unamortized Bal. of Rate Case Exp.	-	84,613	84,613	84,613
7 Unamortized Bal. of Extraordinary Exp.	-	-	-	-
8 Accumulated deferred income taxes			(362,423)	(362,423)
9 Materials and Supplies			-	-
10 Water Inventory			-	-
11 Prepaid Expenses			4,777	4,777
12 Rate Base	\$ 6,183,415	\$ 79,121	\$ 6,262,536	\$ 3,765,796

**Exhibit 3 (EB-3)**

Kiawah Island Utilities, Inc.  
Income Tax Expense - Phase I

	Water	Wastewater	Combined
1 Total Rate Base	\$ 5,482,038	\$ 3,765,796	\$ 9,247,834
2 Equity rate of return	4.403%	4.403%	4.403%
3 Equity return	\$ 241,388	\$ 165,817	\$ 407,205
4 Combined state & federal tax factor	0.594896	0.594896	0.594896
5 Income tax expense	<u>\$ 143,601</u>	<u>\$ 98,644</u>	<u>\$ 242,245</u>
6 Proof:			
7 Equity return	\$ 241,388	\$ 165,817	\$ 407,205
8 Income tax expense	143,601	98,644	242,245
9 Taxable income	<u>\$ 384,989</u>	<u>\$ 264,462</u>	<u>\$ 649,450</u>
10 State tax rate	5%	5%	5%
11 State tax	<u>\$ 19,249</u>	<u>\$ 13,223</u>	<u>\$ 32,473</u>
12 Taxable income	\$ 384,989	\$ 264,462	\$ 649,450
13 State tax	(19,249)	(13,223)	(32,473)
14 Federal taxable income	<u>\$ 365,739</u>	<u>\$ 251,239</u>	<u>\$ 616,978</u>
15 Federal tax rate	34%	34%	34%
16 Federal tax	<u>\$ 124,351</u>	<u>\$ 85,421</u>	<u>\$ 209,772</u>
17 Total tax	<u><u>\$ 143,601</u></u>	<u><u>\$ 98,644</u></u>	<u><u>\$ 242,245</u></u>

**Exhibit 4 (EB-4)**

Kiawah Island Utilities, Inc.  
Combined Revenue Requirement - Phase I

	Company		At		Kiawah Property Owners	
	Test Year 12/31/2010	Adjustments	Proposed Rates	Adjustments	As Adjusted	
1 O & M Expenses	\$ 3,903,807	\$ 102,855	4,006,662	\$ -	\$ 4,006,662	
2 Depreciation	462,407	7,952	470,359	-	470,359	
3 Amortization	25,402	52,135	77,537	-	77,537	
4 Gross Receipts Tax	21,524	22,524	44,047	-	44,047	
5 Property Taxes	227,654	2,638	230,292	-	230,292	
6 Payroll Taxes	44,903	1,619	46,523	-	46,523	
7 State and Federal Income Taxes	145,765	411,946	557,711	(315,466)	242,245	
8 Return	828,466	556,855	1,385,321	(707,716)	677,605	
9 Total Revenue Requirement	\$ 5,659,928	\$ 1,158,524	\$ 6,818,452	\$ (1,023,182)	\$ 5,795,270	
10 Rate Base	\$ 15,278,689	\$ 47,696	\$ 15,326,385		\$ 9,247,834	
11 Rate of return	5.422%		9.0388%		7.3272%	



Kiawah Island Utilities, Inc.  
Water Revenue Requirement - Phase I

	Company			KPOG	
	Test Year 12/31/2010	Adjustments	Pro Forma Proposed Rates	Adjustments	As Adjusted
1 O & M Expenses	\$ 3,202,875	\$ 103,284	\$ 3,306,159	\$ -	\$ 3,306,159
2 Depreciation	262,471	2,139	264,610	-	264,610
3 Amortization	15,005	27,960	42,965	-	42,965
4 Gross Receipts Tax	12,714	21,006	33,720	-	33,720
5 Property Taxes	134,475	967	135,442	-	135,442
6 Payroll Taxes	26,524	818	27,342	-	27,342
7 State and Federal Income Taxes	68,437	358,510	426,947	(283,346)	143,601
8 Return	431,669	(431,669)	0	-	-
9 Total revenue requirement	\$ 3,722,501	\$ 514,684	\$ 4,237,185	\$ (283,346)	\$ 3,953,839

Kiawah Island Utilities, Inc.  
Sewer Revenue Requirement - Phase I

	Company		KPOG	
	Test Year Actual 12/31/2010	Adjustments	Proposed Rates	As Adjusted
1 O & M Expenses	\$ 700,932	\$ (429)	\$ 700,503	\$ 700,503
2 Depreciation	199,936	5,813	205,749	197,334
3 Amortization	10,397	24,175	34,572	34,572
4 Gross Receipts Tax	8,810	1,518	10,328	10,328
5 Property Taxes	93,179	1,671	94,850	94,850
6 Payroll Taxes	18,379	801	19,180	19,180
7 State and Federal Income Taxes	77,328	53,436	130,764	98,644
8 Return	396,797	5,902	402,699	275,926
9 Total revenue requirement	\$ 1,505,758	\$ 92,887	\$ 1,598,645	\$ 1,431,338

**KIAWAH ISLAND UTILITY, INC.**

**DOCKET NO. 2011-317-WS**

**PRE-FILED TESTIMONY OF LYNN M. LANIER**

**BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

**Testimony Prepared: November 16, 2011**

**Hearing Date: November 30, 2011**

**THIS TESTIMONY IS FILED PURSUANT TO PSC LETTER DATED AUGUST 15, 2011. THE INTERVENOR RESERVES THE RIGHT TO PROVIDE ADDITIONAL TESTIMONY CONCERNING FURTHER INTERROGATORY RESPONSES AND REBUTTAL TESTIMONY TO BE PRE-FILED PURSUANT TO SAID ORDER, BY THE APPLICANT AND/OR ANY OTHER PARTY TO THIS PROCEEDING.**

**MR. MOLONY: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS ADDRESS.**

**MR. LANIER:** My name is Lynn M. Lanier and I am employed by GDS Associates, Inc. ("GDS"), a utility consulting and engineering firm with its principal offices in Marietta, GA. I am a Principal in the Firm. My business address is 1850 Parkway Place, Suite 800, Marietta, GA 30067.

**MR. MOLONY: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND:**

**MR. LANIER:** I hold a Bachelor of Science Degree in Industrial Management from the Georgia Institute of Technology, with emphasis in economics and finance.

**MR. MOLONY: PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

1 **MR. LANIER:** I have been employed in the utility business for my entire career of over 38  
2 years. From 1972 to 1977, including part of the time while I was a student in college, I was  
3 employed by Southern Engineering Company of Georgia as a utility rate analyst, where most of  
4 my work was related to determining revenue requirements, costs allocation, and rate design,  
5 primarily on behalf of utility companies. From 1977 to 1989, I was employed in various senior  
6 management positions with electric cooperatives in Georgia and South Carolina, including a 6  
7 year stint as CEO of an electric cooperative in South Carolina. From 1989 until the present, I  
8 have been employed as a Senior Consultant with GDS Associates, Inc., primarily in the areas of  
9 utility rates, cost of service, rate design (both wholesale and retail), and numerous miscellaneous  
10 rate and cost of service projects. In addition, since about 1995 I have been the Firm's Practice  
11 Leader in the US Dept of Defense Utility Privatization Program, where I have led the Firm's  
12 efforts in assisting electric and water/wastewater utilities in their efforts to acquire electric, gas,  
13 water, and wastewater systems on DOD installations. In this regard, we have represented several  
14 investor-owned water/wastewater utility companies and/or affiliates. I have been a Principal in  
15 the Firm since 1995. My professional resume is included in **Appendix A**.

16 **MR. MOLONY: HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE**  
17 **THIS OR OTHER REGULATORY COMMISSIONS, COURTS, ETC.?**

18 **MR. LANIER:** Yes. I have presented expert testimony before the state regulatory commissions  
19 in Indiana, Louisiana, Michigan, Mississippi, Texas, Vermont, and Virginia. In addition I have  
20 presented testimony before the United States Tax Court. I have also presented testimony as a  
21 company witness before the South Carolina Public Service Commission as a fact witness in a

1 territorial matter and in a matter pertaining to the acquisition of a small private power company while I  
2 was CEO of Lynches River Electric Cooperative, Inc. in Pageland, SC.

3 **MR. MOLONY: WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
4 **MATTER?**

5 **MR. LANIER:** The purpose of my testimony is to outline what I believe to be the more  
6 appropriate basis for the equity return and what that return should be and to incorporate proposed  
7 adjustments of witness Ellen Blumenthal with my adjustments, in recommended adjustments to  
8 KIU's revenue requirements and return.

9 **MR. MOLONY: HAVE YOU REVIEWED THE RATE FILING APPLICATION OF**  
10 **KIU IN THIS CASE AND PARTICULARLY THE PROPOSED REVENUE**  
11 **REQUIREMENTS, THE EQUITY RETURN REQUESTED, AND THE OVERALL**  
12 **REVENUE INCREASE REQUESTED?**

13 **MR. LANIER:** Yes I have. According to the Application and the Pre-Filed Testimony of Mr.  
14 Guastella and Mr. White, for the combined water and sewer systems, KIU is requesting adjusted  
15 operating expensed of \$5,433,132 and proposed revenue of \$6,818,155, resulting in net income  
16 after taxes and interest deduction (i.e., the equity return) of \$937,496, which equates to a 13.75%  
17 operating margin. This results in an annual revenue increase of \$1,063,727 or 18.5%.

18 **MR. MOLONY: HOW WAS THE EQUITY RETURN OF \$937,497, DETERMINED?**

19 **MR. LANIER:** As shown on Company filing schedule W-F.1 for water and S-F.1 for sewer, the  
20 operating margin of 13.75% was specified for the criteria for the equity return. Revenue  
21 requirements were then calculated by grossing-up the operating expenses by dividing by (1-  
22 .1375), adjusted for the income tax rate and the gross revenue tax rate. The calculation is:

1 (((Operating Expenses/1-.1375)/1-.373))/1-.00646026). Operating Expenses are then deducted --  
2 from the revenue requirement to arrive at the gross equity return. The income tax and gross  
3 receipts tax are then carved out of the gross equity return to arrive at the net, after tax, equity  
4 return. Dividing that amount by the total revenue requirement equals the desired operating  
5 margin of 13.75%.

6 **MR. MOLONY: DO YOU AGREE WITH THIS METHOD AS A MEANS OF**  
7 **DETERMINING THE APPROPRIATE EQUITY RETURN FOR THE COMPANY?**

8 **MR. LANIER:** No, I do not. As outlined by James C. Bonbright in his famous treatise on  
9 Utility Rate Regulation, "Principles of Public Utility Rates," 1961,

10 "In orthodox practice ... the allowed-for return is arrived at as a multiple of two  
11 factors: the rate base, and the "reasonable" or "fair return, thereon. The rate base,  
12 or "valuation", ...represent the total quantum of invested capital or of property  
13 "values" on which the company is entitled to a reasonable rate of compensation.  
14 The "fair rate of return" reflects whatever annual, percentage rate is found  
15 appropriate in the light both of historical conditions and of conditions prevailing  
16 or anticipated at the time of a rate case.<sup>1</sup>

17 Thus, the proper return to a regulated utility company is based upon a "fair rate of return on rate  
18 base," on the premise that a regulated public utility is entitled to earn a reasonable return on  
19 investment devoted to the public service, and where the return includes provision for a  
20 reasonable return on the equity or stock value of the utility. The Rate of Return is often equated

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<sup>1</sup> Principles of Public Utility Rates, Bonbright, 1961, p150-151

to the “Cost of Capital” wherein such cost, expressed as a percentage, reflects the composite cost of debt, return on Preferred Stock, if applicable, and return on the equity component. In the usual application, the determination of the Cost of Capital is calculated in the following mathematical formula:

Cost of Capital Formula						
Description	Amount	Percent of Total Capital		Annual Cost		Compsite Cost of Capital
Debt	\$5,000,000	50%	x	5%	=	2.500%
Equity	\$5,000,000	50%	x	10%	=	5.000%
	\$10,000,000	100%				
<b>Composite Cost of Capital</b>						<b>7.500%</b>

This Cost of Capital formula, which includes a Return on Equity (or “ROE”), is then applied to the Rate Base (i.e., the Net Utility Plant value, plus allowances for working capital and less deductions for cost free capital to the utility). As illustrated above, the calculated composite Cost of Capital Rate (i.e., 7.5% in the above example) is then applied to the Rate Base to arrive at a return value, which includes the interest on the debt component. Subtracting the interest component dollars from the total allowed return dollars results in the after tax equity return to the utility. In determining revenue requirements, this equity return is then grossed up for state and federal income taxes and any gross receipts taxes and added to the adjusted expense level to arrive at the total revenue requirement.

1 **MR. MOLONY: WHAT IS THE FUNDAMENTAL DIFFERENCE BETWEEN THE**  
2 **RATE OF RETURN APPROACH AND THE OPERATING MARGIN APPROACH AS**  
3 **PROPOSED BY THE COMPANY?**

4 **MR. LANIER:** The difference is that in the Rate of Return approach, the equity return to the  
5 owner is a function of the owner's equity investment and a fair return on that investment,  
6 whereas the Operating Margin approach provides a return or profit to the owner, regardless of  
7 the amount of owner's equity or even whether there is any equity.

8 **MR. MOLONY: ARE THERE EVER ANY CIRCUMSTANCES WHERE OPERATING**  
9 **MARGIN WOULD BE AN APPROPRIATE MEANS OF DETERMINING A FAIR**  
10 **EQUITY RETURN?**

11 **MR. LANIER:** Yes there are. And many are and have been related to the situations with  
12 respect to water and wastewater utility companies. My firm has been involved in recent years  
13 with the acquisition of numerous small water companies in the state of Texas by larger regulated  
14 utility type firms. With most of the small water companies acquired, the companies are  
15 undercapitalized, or poor or non-existent records exist as to the actual investment that has been  
16 made by the company, or what records are available are unreliable. In some cases there may  
17 actually be no equity. In such cases, the attempted use of Rate of Return on Rate Base would not  
18 allow the company or the acquiring company to earn a profit, yet it was often in the public  
19 interest for the small systems to be acquired by the regulated utility company to assure quality,  
20 reliable service. Operating margin, in cases like these, is really the only practical means of  
21 providing a profit component to the company or the acquiring company.



1 In addition, with some water/wastewater utilities, where they are small in size and where most  
2 of the utility plant is new and has been largely contributed by developers, there may be only a  
3 very small net utility investment by the company, insufficient to generate a reasonable profit to  
4 the company through the use of rate of return on rate base. So these and other similar  
5 circumstances may require a different approach to determine an equity return or profit margin to  
6 incentivize the owner to operate the company well.

7 **MR. MOLONY: WHY DO YOU NOT FEEL THAT OPERATING MARGIN SHOULD**  
8 **BE THE CRITERION FOR AN EQUITY RETURN FOR KIU?**

9 **MR. LANIER:** KIU was established from the beginning as a regulated utility company in the  
10 state of South Carolina. As such, it has kept its books and records in accordance with  
11 PSC/NARUC guidelines, including proper accounting for plant investment. It is not a new,  
12 undercapitalized company, but rather, has a substantial net plant investment and rate base, such  
13 that Rate of Return on Rate Base would be entirely appropriate for determining the equity return.

14 **MR. MOLONY: HAS THE COMPANY PRESENTED ANY INFORMATION IN ITS**  
15 **FILING RELATIVE TO RATE BASE AND RETURN ON RATE BASE?**

16 **MR. LANIER:** Yes. Schedule A-3 of the company's filing is a schedule labeled, "Capital  
17 Structure and Rate of Return", on which the company has clearly presented a proposed utility  
18 rate base of \$15,326,381, and on which it has calculated an overall rate of return of 9.037%, and  
19 as part of that composite value, a Return on Equity of 13.2%, based on the equity  
20 return/operating Margin it is requesting of 13.75% of Revenue.

21 **MR. MOLONY: DO YOU FEEL THAT THIS OVERALL RATE OF RETURN OF**  
22 **9.037% AND RETURN ON EQUITY OF 13.2% IS REASONABLE AND REALISTIC?**

1 **MR. LANIER:** No I do not. In my view, a return on equity of 13.2% is excessive and far  
2 beyond the range of reasonableness for the current economic conditions as a whole and the  
3 economic condition of KIU.

4 **MR. MOLONY: WHAT IS THE BASIS OF YOUR BELIEF THAT THE RETURN ON**  
5 **EQUITY IS EXCESSIVE AND UNREALISTIC?**

6 **MR. LANIER:** There are several measures that I think are appropriate. First of all, I would  
7 point to recent decisions by this commission, specifically the United Utilities (“United  
8 Utilities”) order of May 17, 2010, the Tega Cay Water Service, Inc. (“Tega Cay”) Order of  
9 August 16, 2010, and the Carolina Water Service, Inc. (“Carolina Water”) order of October 24,  
10 2011. In United utilities, Dr. Douglas Carlisle, for ORS, recommended a 10.06% Return on  
11 Equity, based on a return on rate base calculation, and the commission found that the appropriate  
12 rate of return on equity was 10%. The Commission denied the requested rate relief, ruling that  
13 the company’s current earnings of 10% ROE were sufficient and that the company would be  
14 allowed the opportunity to continue to earn that return. In Tega Cay, the Commission found that  
15 the use of rate of return on rate base was the appropriate methodology for use in determining the  
16 reasonableness of Tega Cay’s rates. ORS witness Dr. Douglas Carlisle recommended a return on  
17 equity of 9.08% to 10.07%, and the commission settled on a ROE of 9.57%, the mid-point of Dr.  
18 Carlisle’s recommended range. In Carolina Water, ORS witness Dr. Douglas Carlisle  
19 recommended in his testimony a ROE range of 9.02% to 10.03%. In its order, the Commission  
20 denied the requested rate relief, but determined that the 6.42% ROE, as calculated by an ORS  
21 staff witness, was sufficient under the circumstances, but also acknowledged that the Company  
22 would continue to have the opportunity to earn the authorized ROE of 9.4% granted in Order No.

1 2008-855. Finally, and perhaps more comprehensive and a tool which could be applied in this  
2 case, is a report prepared annually by the Florida Public Service Commission ("FPSC"). The  
3 FPSC only recognizes the Return on Rate Base methodology for determining the allowed return  
4 and allowed equity return for water and wastewater utilities. In accordance with Florida statutes,  
5 the FPSC is required to "establish, at least once each year, a leverage scale or scales that reflect  
6 the range of returns on common equity ..." <sup>2</sup> I have provided as **Exhibit 1 (LML-1)** the FPSC's  
7 order establishing the authorized range of returns on common equity for water and wastewater  
8 utilities, issued July 5, 2011. In this order, which considers the results of the Discounted Cash  
9 Flow (DCF) Model and the Capital Asset Pricing Model (CAPM), the FPSC determined the  
10 appropriate range of returns on equity to be 8.74% at 100% equity to 11.16% at 40% equity. The  
11 leverage formula in the order provides a sliding scale for the determination of the ROE, based on  
12 the equity level, as follows:

13 
$$\text{ROE} = 7.13\% + 1.610/\text{ER} \quad (\text{where ER} = \text{Equity ratio})$$

14 Thus, for a utility with 50% equity, the ROE would be 10.35%. Applying this to KUI in this  
15 case and using the company's claimed Equity ratio of 46.35%, the ROE would be 10.6%. While  
16 I acknowledge that the SC PSC is under no obligation to adopt this approach in this case, it does  
17 provide a reasonable means of gauging an appropriate ROE in this case. Together with the  
18 Commission orders in United Utilities, Tega Cay, and Carolina Water, it appears that the  
19 Commission has considered reasonable ranges of ROE, under the circumstances of each case to  
20 be in the range of 6.42% to 9.57%.

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<sup>2</sup> Florida Administrative Law Section 25-30.415 (1)

1 **MR. MOLONY: SO BASED ON YOUR REVIEW OF THE RECENT COMMISSION --**  
2 **ORDERS AND THE FLORIDA PSC REPORT, WHAT DO YOU CONCLUDE AS TO A**  
3 **REASONABLE ROE IN THIS CASE?**

4 **MR. LANIER:** Based on the information cited above, it would appear that an authorized ROE  
5 in the range of 9.5% to 10.6% would be appropriate as an equity return for KIU.

6 **MR. MOLONY: HAVE YOU DETERMINED WHAT EFFECT THE USE OF THE**  
7 **RATE OF RETURN METHODOLOGY AND THE USE OF THE ROE RANGES YOU**  
8 **ARE SUGGESTING WOULD HAVE ON THE COMPANY'S REQUESTED REVENUE**  
9 **REQUIREMENT?**

10 **MR. LANIER:** Yes I have. On **Exhibit 2 (LML-2)**, which is a replication of the company's  
11 filing exhibit A-3, I have replaced the equity return shown by the company of 13.1966% with  
12 9.5% in one scenario and 10.6% in another scenario. Doing so results in an overall rate of return  
13 of 7.33% at 9.5% ROE and 7.84% at 10.6% ROE. Applying these to the Company's filing  
14 exhibit A-5, as shown on **Exhibit 3 (LML-3)**, results in overall Equity Return needs of \$674,889  
15 and \$753,034, respectively, before tax gross-up, but which are comparable to the Company's  
16 request of \$937,496. After applying the tax gross-up, the total revenue requirement increase  
17 associated with each scenario is \$633,434 under the 9.5% ROE and \$761,335 under the 10.6%  
18 ROE, which translate into 11.0% and 13.2% increases in revenue, respectively.

19 **MR. MOLONY: HAVE YOU ALSO CONSIDERED THE EFFECT ON REVENUE**  
20 **REQUIREMENTS AND REQUIRED REVENUE INCREASES ASSOCIATED WITH**  
21 **YOUR COLLEAGUE, MS. BLUMENTHAL'S, TESTIMONY?**

1 **MR. LANIER:** Yes I have. In Ms. Blumenthal's testimony, she recommends reductions in  
2 Rate Base for the water and sewer systems, for rate making purposes, associated with the three  
3 land purchases that KIU made from KRA in 2008, 2009, and 2009, and for a sewer line that KIU  
4 purchased from KRA in 2005. In its filing, as shown on Schedule A-3, the Company proposed a  
5 Combined Water and Sewer Rate Base of \$15,326,383, representing \$9,063,847 for the Water  
6 System and \$6,262,534 for the Sewer System. Ms. Blumenthal recommends that the Water Rate  
7 Base be reduced to \$5,482,038 and that the Sewer System Rate Base be reduced to \$3,765,796,  
8 such that the total adjusted Rate Base for the combined Water and Sewer Systems would be  
9 reduced to \$9,247,834. In addition, she has recommended a reduction in depreciation expense  
10 associated with the purchase of the sewer line in 2005, along with reductions in State and Federal  
11 income taxes, associated with lower revenues, driven by the lower rate base. On my **Exhibit 4**  
12 **(LML-4)**, I have shown the Equity Return associated with Ms. Blumenthal's recommended  
13 combined system Rate Base of \$9,247,834 at both the 9.5% ROE and at the 10.6% ROE. Under  
14 the 9.5% ROE, the Equity Return declines from \$674,889 to \$407,223 and under the 10.6%  
15 ROE, the Equity Return declines from \$753,034 to \$454,375. On **Exhibit 5 (LML-5)**, I have  
16 recalculated the impact on the overall revenue requirements of the combined system, under both  
17 the 9.5% ROE Scenario and the 10.6% ROE Scenario. As shown, there is an overall revenue  
18 requirement reduction of \$94,586 under the 9.5% ROE and a \$17,412 reduction under the 10.6%  
19 ROE. These translate into revenue decreases of 1.6% and 0.3%, respectively, indicating that the  
20 Company really does not need any revenue increase, and in fact, could reduce rates slightly.

21 **MR. MOLONY: DOES THIS CONCLUDE YOUR TESTIMONY?**

22 **MR. LANIER:** Yes, it does.

1    **END OF DIRECT TESTIMONY**

2

**LIST OF EXHIBITS TO ACCOMPANY TESTIMONY**

- EXHIBIT 1 (LML-1) FPSC ORDER NO. PSC-11-0287-PAA-WS –Establishing Authorized Range of Returns on Common Equity for Water and Wastewater Utilities (7/5/2011)**
- EXHIBIT 2 (LML-2) Capital Structure, Rates of Return, and Return on Equity (9.5% and 10.6% ROE)**
- EXHIBIT 3 (LML-3) Revenue Requirements (9.5% and 10.6% Returns on Equity)**
- EXHIBIT 4 (LML-4) Capital Structure, Rates of Return, and Return on Equity (9.5% ROE and 10.6% ROE) Revised Rate Base**
- EXHIBIT 5 (LML-5) Revenue Requirements (9.5% and 10.6% Returns on Equity) – Revised Rate Base**
- EXHIBIT 5 (LML-5) Revenue Requirements (9.5% and 10.6% Returns on Equity) – Revised Rate Base**

## **Annex A (LML-A)**



**EDUCATION:** Bachelor of Science in Industrial Management,  
Co-Operative Plan, Georgia Institute of Technology, 1975

**EXPERIENCE:**

Mr. Lanier is a Principal in the Firm and has over thirty-eight years experience in the electric utility industry with an extensive background in the areas of management, operations, and finance, primarily with electric distribution systems. His experience includes a broad range of retail and wholesale rate, financial analysis, marketing, operational analysis, valuation, and merger/acquisition consulting projects. He also served as General Manager/CEO of an electric cooperative in South Carolina for 5-1/2 years.

Employment Experience:

1988 - Present: GDS Associates, Inc. - Mr. Lanier is responsible for providing services to and directing projects primarily for electric distribution systems in a number of areas including financial analysis and planning; reorganization studies such as mergers and acquisitions, consolidations, and valuation studies; marketing programs; demand-side planning and analysis; productivity studies; retail and wholesale rates; and various costs analyses, including outdoor/street lighting rates, joint pole use attachment rates, etc.

His experience at GDS includes demand-side planning, end-use analysis, marketing program analyses and development, development of demand-side/marketing program incentives, the development of electric service contracts, agreements, and easements, revenue and power cost forecasting and budgeting, competitive rate analyses, evaluation and development of industrial service rates, retail rate and cost-of-service studies, policy and service rule development, development of special rates, wholesale rate design, operational/management evaluations, cost reduction studies, valuation studies, privatization/acquisition projects, and certificated service area dispute resolution, along with a number of related projects. Since 1995, he has been the Firm's Practice Leader in the federal DOD Utility Privatization Program, primarily representing electric and water/wastewater utility companies and affiliates in efforts to acquire utility privatization contracts.

1983 - 1988: Lynches River Electric Cooperative, Inc. - As General Manager, Mr. Lanier was Chief Executive Officer responsible for the operation of the Cooperative. Major achievements include: development of planning, budgeting, and cost tracking systems; implementation of automated accounting systems; rate analyses and development of special industrial rates

and contracts; development of industrial service proposals; and development of automated feasibility analysis for facilities investment. Mr. Lanier also developed numerous forms of contracts, agreements, and easements.

Particularly noteworthy among his accomplishments were his successful efforts in the acquisition of a small private power company, including all feasibility analyses, REA lien accommodation for 100% private financing, negotiation of terms of sale and closing of same, filings and testimony before the South Carolina Public Service Commission, and timely integration into the Cooperative's distribution system.

Mr. Lanier was instrumental in the development of a G&T-wide power marketing program and led its implementation by developing and implementing the first member system comprehensive marketing program, including selective appliance promotion toward target markets, incentive rates, financing and cost sharing program, and general promotional program.

In addition, Mr. Lanier was personally involved and participated extensively in numerous system engineering studies, power requirements studies, loan applications, borrower environmental reports, load management system implementation, and numerous "service territory" related matters.

1978 - 1983: Walton Electric Membership Corporation, Monroe, Georgia - As Manager of Administrative Services, Mr. Lanier was responsible for organizational planning, management development, personnel administration, staff services, retail rates and service rules and regulations. Mr. Lanier's activities included annual business plans and budgets, rate and cost-of-service studies, industrial service proposals, long-range organizational plan, safety management program, development of an extensive management performance report, extensive bylaw revisions, and policy development.

1976 - 1978: Colquitt Electric Membership Corporation, Moultrie, Georgia - As Administrative Assistant, Mr. Lanier's responsibilities included organization planning, budgeting, management systems, policy development, and general administrative responsibilities. His activities included development of a planning and budgeting system, a large power load research project, data processing study, re-writing the policy manual, and numerous other general analyses and activities.

1971 - 1976: Southern Engineering Company of Georgia, Atlanta, Georgia - Mr. Lanier began work with Southern Engineering Company as a rate analyst while a student at Georgia Institute of Technology. Upon graduation in 1975, he

was employed as a rate and financial consultant. His responsibilities included retail rate and cost-of-service analyses, preparation and delivery of expert testimony before various public service commissions, presentation of reports to management and boards of directors of various utilities, preparation of financial forecasts for electric cooperatives, and providing other financial and rate related advice and services to electric utilities, including assistance with service rules, regulations, and contracts.

#### **REGULATORY EXPERIENCE:**

Mr. Lanier has presented expert testimony and/or prepared testimony and exhibits in retail and wholesale rate and cost-of-service matters before the following state utility regulatory commissions:

Louisiana Public Service Commission  
Vermont Public Service Commission  
Public Service Commission of Indiana  
Virginia State Corporation Commission  
Public Utility Commission of Texas  
Michigan Public Service Commission  
Mississippi Public Service Commission

In addition, Mr. Lanier also submitted testimony and appeared before the South Carolina Public Service Commission as a Company witness on two separate occasions concerning a territorial matter and in regard to the acquisition of a small private power company.

Mr. Lanier has also submitted an expert report and testified before the US Tax Court on behalf of the Internal Revenue Service. He has also provided expert reports in State Courts.

#### **SPECIFIC CONSULTING EXPERIENCE – SELECTED EXAMPLES:**

[ \* Projects in which Mr. Lanier had a significant role but not exclusive project responsibility]

- VECO Alaska, Inc.
  - **Utility Privatization Proposal - Alaska Installations** – Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- TDX Power
  - **Natural Gas Privatization with ENSTAR** - Project involved the inventory of all natural gas distribution plant and classification in accordance with FERC Uniform

System of Accounts for Gas Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- First Electric Cooperative Corp.
  - **Privatization Assistance: Little Rock AFB** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- C&L Electric Cooperative Corporation
  - **Pine Bluff Arsenal Utility Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Gulf Coast Electric Cooperative, Inc.
  - **NWS CSS Panama City Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
  - **Tyndall AFB Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- North Georgia Electric Membership Corporation
  - **Outdoor Lighting Rate Study** – Project involved the review of TVA prescribed lighting rate designs and review of all non-power related Street and Outdoor lighting related operating costs and margin requirements and establishment of schedule of non-power related fixed charges for each type of fixture and configuration offered.
- Rayle Electric Membership Corp.
  - **Rate And Cost Of Service Study** – Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Colquitt Electric Membership Corp.
  - **Development Of Outdoor Lighting Rates** – Project involved comprehensive

- review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
  - **Retail Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Retail Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Hart Electric Membership Corp.
  - **Cost of Service Analysis And Retail Rate Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Satilla Rural Electric Membership Corporation
  - **Retail Rate & Cost of Service Study (1992)** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Rate and Cost of Service Study (1998)** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Mitchell Electric Membership Corporation
  - **Financial Review And Rate Adjustment** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
  - **Privatization: MCLB-Albany, GA** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- Ocmulgee Electric Membership Corporation
  - **Retail Rate & Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Cobb Electric Membership Corporation
  - **Privatization-Dobbins, AFB** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Three Notch Electric Membership Corporation
  - **Retail Rate And Cost of Service** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Develop School Rate, Lighting Package** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for proposed new Street/Parking Lot Lighting options to be offered to consumer
  - **Acquisition Analysis** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Tri-County (GA) Electric Membership Corporation
  - **Develop Lighting Rates \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Coastal Electric Cooperative
  - **Outdoor Lighting Schedule \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Coweta-Fayette Electric Membership Corporation
  - **Ft. McPherson and Ft. Gillem Privatization Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing

valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- Cooperative Power, Inc.
  - **Privatization of Ft. Benning Distribution System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Leavenworth-Jefferson Electric Cooperative
  - **Proposal to Own, Operate, and Maintain the Lighting at Fort Leavenworth** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Pennyrile Rural Electric Cooperative Corp.
  - **Privatization Assistance – Ft. Campbell** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Blue Grass Energy, Inc.
  - **Privatization Assistance: Blue Grass Army Depot (BGAD)** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Nolin Rural Electric Cooperative Corp.
  - **Fort Knox RFP Review and Proposal** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Chicopee Municipal Lighting Plant
  - **Westover ARB Electric System Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- 4-County Electric Power Association
  - **Privatization Assistance: Columbus Air Force Base** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Singing River Electric Power Assn.
  - **Privatization Assistance – Pascagoula** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Laclede Electric Cooperative
  - **Privatization Assistance: Ft. Leonard Wood** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Haywood Electric Membership Corporation
  - **Cost Of Service And Rate Design** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Otero County Electric Cooperative, Inc.
  - **Privatization of White Sands Mis. Range** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- The Energy Cooperative
  - **Retail Rate Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Aiken Electric Cooperative, Inc.
  - **Retail Rate And Cost Of Service Study** - Project involved comprehensive



revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.

- Fairfield Electric Cooperative, Inc.
  - **Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Retail; Rate & Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Berkeley Electric Cooperative, Inc.
  - **Retail Rate, Cost of Service, And Marketing Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Retail Rate and Cost of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
  - **Commercial Lighting Program** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered to Commercial consumers.
  - **Financial Review and Rate Revision** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
- Horry Electric Cooperative, Inc.
  - **Retail Rate & Cost of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.

- Mid-Carolina Electric Cooperative, Inc.
  - **Lighting Rate Analysis** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
  - **Retail; Rate And Cost Of Service Study** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Blue Ridge Electric Cooperative, Inc.
  - **Athletic Field Lighting Facilities \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for proposed new Athletic Field Lighting options to be offered to consumer
- Palmetto Electric Cooperative, Inc.
  - **Cost Of Service And Rate Study 1988 \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
  - **Cost Of Service And Rate Study \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
  - **End Use Cost And Rate Analysis \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- York Electric Cooperative, Inc.
  - **Retail Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
  - **Retail Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
  - **Update 1999 Rate Study** - Project involved comprehensive revenue requirements study and limited redesign of retail rates, including the Street and Outdoor Lighting rates
- Tri-County (TN) Electric Membership Corp.

- **Cost of Service and Retail Rate Study – 1997** - Project involved comprehensive revenue requirements and allocated cost study for all retail rate classes, including the Street and Outdoor Lighting Class, and development/design of retail rates for all consumer classes, including appropriate charges for Street and Outdoor Lighting options offered to consumers.
- Southwest Tennessee Electric Membership Corp.
  - **NSA Mid-South Utilities Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Sequachee Valley Electric Cooperative, Inc.
  - **Arnold AFB Utility Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Upshur-Rural Electric Cooperative, Inc.
  - **Outdoor Lighting Rate Schedule Revision \*** - Project involved comprehensive review of power and non-power related costs and margin requirements and rate design for existing and new Street and Outdoor Lighting options offered or proposed to be offered
- Fort Belknap Electric Cooperative, Inc.
  - **Privatization of Sheppard AFB Electric System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Tri-County (TX) Electric Cooperative, Inc.
  - **Privatization Assistance - NAS JRB Ft. Worth** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Rio Grande Electric Cooperative, Inc.
  - **Privatization of Laughlin RFB Eclectic System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- EG&G / KPMG
  - **Transfer of Kelly AFB Elec. & Gas Systems to CPS** - Project involved the inventory of all electric and natural gas distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric and Gas Systems, respectively, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Southside Electric Cooperative
  - **Privatization Assistance - Fort Pickett** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Prince George Electric Cooperative
  - **Privatization Assistance: Ft. Lee** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
  - **Privatization Assistance - Defense Supply Center, Richmond, VA** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Community Electric Cooperative
  - **Privatization Assistance: FT. Eustis, FT. Monroe, & FT. Story** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
  - **Privatization Assistance - Norfolk Naval Bases** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
- Alaska Power and Telephone
  - **Ft. Buchanan Utility Privatization** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.
  - **Fort Lewis Electric Distribution Privatization** - Project involved the inventory

of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

- Bluestem Electric Cooperative
- D.S.& O. Rural Electric Coop. Association
- Flint Hills Rural Electric Coop. Assoc., Inc.
  - **Privatization Assistance: Ft. Riley Electric System** - Project involved the inventory of all electric distribution plant and classification in accordance with FERC Uniform System of Accounts for Electric Systems, and establishing valuation on the basis of Replacement Cost Depreciated and Original Cost Depreciated.

**LYNN M. LANIER**

***TESTIMONY EXPERIENCE***

Client/State	Matter/Testimony	Year	Case or Docket No.
Fulton County REMC – Indiana	Retail Rate Filing: Complete direct testimony in support of filing	1976	N/A
Panola Harrison Electric Cooperative Inc. – Texas	Retail Rate Filing: Direct testimony in support of proposed new service. Direct testimony in support of Rules and Regulations	1989	9214
Sam Rayburn G&T Electric Cooperative, Inc. (SRG&T) – Texas	Wholesale Rate Filing; Direct Testimony in support of wholesale rate schedules Supplemental testimony concerning economic development rate issues	1992	10982
Northeast Texas Electric Cooperative, Inc. (NTEC) – Texas	Wholesale Rate Filing: Rebuttal testimony concerning demand-side management goals and objectives	1993	11384
Houston County Electric Cooperative, Inc. – Texas	Filing for Retail Rate For High Load Factor Loads: Direct testimony in support of rate design and rate schedule and justification therefore	1992	11660
Tex-La Electric Cooperative of Texas, Inc. (Tex-La) - Texas	Application of Texas Utilities Electric Company For Authority To Change Rates: Direct testimony in support of alternative wholesale rate design	1993	11735
Daniel, Coker, Horton & Bell, PA, on behalf of Tombigbee Electric Association, MS	City of Tupelo, MS vs Tombigbee EPA	2007	CV04-211(g)L
Internal Revenue Service (US Tax Court), TX	Protected by NDA	2008	Protected by NDA

**LYNN M. LANIER**

***ARTICLES***

1. *Privatization of Utility Distribution Systems on Military Bases*: Transactions Newsletter of GDS Associates, Inc.; Vol. No. 498; Dec, 1998.
2. *Evaluating Opportunities: Uncle Sam Privatizes Utility Systems; and Military Privatization: Nuts, Bolts Issues*; Electric Light and Power Magazine, March, 1999.

**APPEARANCES IN FEDERAL COURT**

U.S. Tax Court – On Behalf of the Internal Revenue Service (2008)

**Exhibit 1 (LML-1)**



BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.	DOCKET NO. 110006-WS ORDER NO. PSC-11-0287-PAA-WS ISSUED: July 5, 2011
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The following Commissioners participated in the disposition of this matter:

ART GRAHAM, Chairman  
LISA POLAK EDGAR  
RONALD A. BRISÉ  
EDUARDO E. BALBIS  
JULIE I. BROWN

NOTICE OF PROPOSED AGENCY ACTION  
ORDER ESTABLISHING AUTHORIZED RANGE OF RETURNS ON COMMON EQUITY  
FOR WATER AND WASTEWATER UTILITIES

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 26-22.029, Florida Administrative Code.

BACKGROUND

Section 367.081(4)(f), Florida Statutes (F.S.), authorizes this Commission to establish, not less than once each year, a leverage formula to calculate a reasonable range of returns on equity (ROE) for water and wastewater (WAW) utilities. The leverage formula methodology currently in use was established in Order No. PSC-01-2514-FOF-WS.<sup>1</sup> On October 23, 2008, this Commission held a formal hearing in Docket No. 080006-WS to allow interested parties to provide testimony regarding the validity of the leverage formula. Based on the record in that proceeding, we approved the 2008 leverage formula in Order No. PSC-08-0846-FOF-WS.<sup>2</sup> In

<sup>1</sup> See Order No. PSC-01-2514-FOF-WS, issued December 24, 2001, in Docket No. 010006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

<sup>2</sup> See Order No. PSC-08-0846-FOF-WS, issued December 31, 2008, in Docket No. 080006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

that order, we reaffirmed the methodology that was previously approved in Order No. PSC-01-2514-FOF-WS. In 2010, the Commission established the leverage formula currently in effect by Order No. PSC-10-0401-PAA-WS.<sup>3</sup>

This Order utilizes the current leverage formula methodology established in Order No. PSC-08-0846-FOF-WS. This methodology uses returns on equity (ROE) derived from financial models applied to an index of natural gas utilities. Based on the results of our annual review, there is an insufficient number of WAW utilities that meet the requisite criteria to assemble an appropriate proxy group. Therefore, since 2001, we have used natural gas utilities as the proxy companies for the leverage formula. There are many natural gas utilities that have actively traded stocks and forecasted financial data. We used natural gas utilities that derive at least 49 percent of their revenue from regulated rates. These utilities have market power and are influenced significantly by economic regulation. As explained in the body of this Order, the model results based on natural gas utilities are adjusted to reflect the risks faced by Florida WAW utilities.

Although subsection 367.081(4)(f), F.S., authorizes this Commission to establish a range of returns for setting the authorized ROE for WAW utilities, we retain the discretion to set an ROE for WAW utilities based on record evidence in any proceeding. If one or more parties file testimony in opposition to the use of the leverage formula, we will determine the appropriate ROE based on the evidentiary record in that proceeding. We have jurisdiction pursuant to Section 367.081, F.S.

### DECISION

The current leverage formula methodology was applied using updated financial data, and is calculated as follows:

$$\text{Return on Common Equity} = 7.13\% + 1.610/\text{Equity Ratio}$$

Where the Equity Ratio = Common Equity / (Common Equity + Preferred Equity + Long-Term and Short-Term Debt)

$$\text{Range: } 8.74\% @ 100\% \text{ equity to } 11.16\% @ 40\% \text{ equity}$$

Section 367.081(4)(f), F.S., authorizes us to establish a leverage formula to calculate a reasonable range of returns on equity for WAW utilities. We must establish this leverage formula not less than once a year.

We note that the leverage formula depends on four basic assumptions:

- 1) Business risk is similar for all WAW utilities;

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<sup>3</sup> See Order No. PSC-10-0401-PAA-WS, issued June 18, 2010, in Docket No. 100006-WS, In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

- 2) The cost of equity is an exponential function of the equity ratio but a linear function of the debt to equity ratio over the relevant range;
- 3) The marginal weighted average cost of investor capital is constant over the equity ratio range of 40 percent to 100 percent; and
- 4) The debt cost rate at an assumed Moody's Baa3 bond rating, plus a 50 basis point private placement premium and a 50 basis point small utility risk premium, represents the average marginal cost of debt to a Florida WAW utility over an equity ratio range of 40 percent to 100 percent.

For these reasons, the leverage formula is assumed to be appropriate for the average Florida WAW utility.

The leverage formula relies on two ROE models. We adjusted the results of these models to reflect differences in risk and debt cost between the index of companies used in the models and the average Florida WAW utility. Both models include a four percent adjustment for flotation costs. The models are as follows:

- A Discounted Cash Flow (DCF) model applied to an index of natural gas (NG) utilities that have publicly traded stock and are followed by the Value Line Investment Survey (Value Line). This DCF model is an annual model and uses prospective growth rates. The index consists of 9 companies that derive at least 49 percent of their total revenue from gas distribution service. These companies have a median Standard and Poor's bond rating of A.
- A Capital Asset Pricing Model (CAPM) using a market return for companies followed by Value Line, the average yield on the Treasury's long-term bonds projected by the Blue Chip Financial Forecasts, and the average beta for the index of NG utilities. The market return for the 2011 leverage formula was calculated using a quarterly DCF model.

We averaged the indicated returns of the above models and adjusted the result as follows:

- A bond yield differential of 57 basis points is added to reflect the difference in yields between an A/A2 rated bond, which is the median bond rating for the NG utility index, and a BBB-/Baa3 rated bond. Florida WAW utilities are assumed to be comparable to companies with the lowest investment grade bond rating, which is Baa3. This adjustment compensates for the difference between the credit quality of "A" rated debt and the credit quality of the minimum investment grade rating.
  - A private placement premium of 50 basis points is added to reflect the difference in yields on publicly traded debt and privately placed debt, which is illiquid. Investors require a premium for the lack of liquidity of privately placed debt.
  - A small utility risk premium of 50 basis points is added because the average Florida WAW utility is too small to qualify for privately placed debt.
-

After the above adjustments, the resulting cost of equity estimate is included in the average capital structure for the NG utilities. The derivation of the recommended leverage formula using the current methodology with updated financial data is presented in Attachment 1.

For administrative efficiency, the leverage formula is used to determine the appropriate return for an average Florida WAW utility. Traditionally, the Commission has applied the same leverage formula to all WAW utilities. As is the case with other regulated companies under the our jurisdiction, we have discretion in the determination of the appropriate ROE based on the evidentiary record in any proceeding. If one or more parties file testimony in opposition to the use of the leverage formula, we will determine the appropriate ROE based on the evidentiary record in that proceeding.

Based on the foregoing, we find it appropriate to cap returns on common equity at 11.16 percent for all WAW utilities with equity ratios less than 40 percent. We believe that this will discourage imprudent financial risk. This cap is consistent with the methodology in Order No. PSC-08-0846-FOF-WS.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the leverage formula methodology, summarized herein and in Attachment 1, is hereby approved. It is further

ORDERED that Attachment 1 is incorporated herein by reference. It is further

ORDERED that returns on common equity are hereby capped at 11.16 percent for all water and wastewater utilities with equity ratios of less than 40 percent in order to discourage imprudent financial risk. It is further

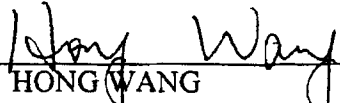
ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall remain open to allow our staff to monitor changes in capital market conditions and to readdress the reasonableness of the leverage formula as conditions warrant.

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ORDER NO. PSC-11-0287-PAA-WS  
DOCKET NO. 110006-WS  
PAGE 5

By ORDER of the Florida Public Service Commission this 5th day of July, 2011.

  
HONG WANG  
Chief Deputy Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399  
(850) 413-6770  
[www.floridapsc.com](http://www.floridapsc.com)

CERTIFICATE OF SERVICE

In accordance with Section 28-106.110, Florida Administrative Code, documents are electronically served on each party or each party's counsel or representative at the last e-mail address of record. Where there is no e-mail address, documents are electronically served via the last facsimile number of record and, if unavailable, documents are served via U.S. Mail at the last address of record.

( S E A L )

CMK

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on July 26, 2011.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

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## SUMMARY OF RESULTS

### Leverage Formula Update

	<u>Updated Results</u>	<u>Currently in Effect</u>
(A) DCF ROE for Natural Gas Index	8.25%	8.92%
(B) CAPM ROE for Natural Gas Index	<u>9.40%</u>	<u>8.58%</u>
AVERAGE	8.83%	8.75%
Bond Yield Differential	0.57%	0.53%
Private Placement Premium	0.50%	0.50%
Small-Utility Risk Premium	0.50%	0.50%
Adjustment to Reflect Required Equity		
Return at a 40% Equity Ratio	0.76%	0.57%
Cost of Equity for Average Florida WAW		
Utility at a 40% Equity Ratio	11.16%	10.85%

### 2010 Leverage Formula (Currently in Effect)

Return on Common Equity	=	7.46% + 1.356/ER
Range of Returns on Equity	=	8.82% - 10.85%

### 2011 Leverage Formula

Return on Common Equity	=	7.13% + 1.610/ER
Range of Returns on Equity	=	8.74% - 11.16%

Marginal Cost of Investor Capital  
Average Water and Wastewater Utility

<u>Capital Component</u>	<u>Ratio</u>	<u>Marginal Cost Rate</u>	<u>Weighted Marginal Cost Rate</u>
Common Equity	49.30%	10.40%	5.13%
Total Debt	<u>50.70%</u>	7.13% *	<u>3.61%</u>
	100.00%		8.74%

A 40% equity ratio is the floor for calculating the required return on common equity. The return on equity at a 40% equity ratio is  $7.13\% + 1.610/.40 = 11.16\%$

Marginal Cost of Investor Capital  
Average Water & Wastewater Utility at 40% Equity Ratio

<u>Capital Component</u>	<u>Ratio</u>	<u>Marginal Cost Rate</u>	<u>Weighted Marginal Cost Rate</u>
Common Equity	40.00%	11.16%	4.46%
Total Debt	<u>60.00%</u>	7.13% *	<u>4.28%</u>
	100.00%		8.74%

Where: ER = Equity Ratio = Common Equity/(Common Equity + Preferred Equity + Long-Term Debt + Short-Term Debt)

\* Assumed Baa3 rate for March 2011 plus a 50 basis point private placement premium and a 50 basis point small utility risk premium.

Sources: Moody's Credit Perspectives and Value Line Selection and Opinion



# ANNUAL DISCOUNTED CASH FLOW MODEL

INDEX	NATURAL GAS INDEX	VALUE LINE ISSUE: March 11, 2011									
		DIV0	DIV1	DIV2	DIV3	DIV4	EPS4	ROE4	GRI-4	GR4+	APRIL HI-PR LO-PR AVER-PR
AGL RESOURCES INC.	1.80	1.84	1.88	1.92	1.96	1.96	3.75	12.50	1.0213	1.0597	41.61 38.58 40.095
ATMOS ENERGY CORPORATION	1.36	1.38	1.40	1.43	1.45	1.45	2.70	9.00	1.0166	1.0417	34.94 32.76 33.850
LACLEDE GROUP, INC.	1.61	1.65	1.70	1.75	1.80	1.80	3.15	10.00	1.0294	1.0429	38.98 36.30 37.640
NICOR INC.	1.86	1.86	1.86	1.86	1.86	1.86	2.80	10.00	1.0000	1.0336	55.50 52.22 53.860
NORTHWEST NATURAL GAS CO.	1.72	1.76	1.77	1.79	1.80	1.80	3.20	10.00	1.0075	1.0438	46.37 44.08 45.225
PIEDMONT NATURAL GAS CO., INC.	1.15	1.19	1.23	1.27	1.31	1.31	1.90	12.50	1.0325	1.0388	32.00 29.00 30.500
SOUTH JERSEY INDUSTRIES, INC.	1.48	1.60	1.72	1.86	2.00	2.00	4.10	17.50	1.0772	1.0896	58.03 54.05 56.040
SOUTHWEST GAS CORPORATION	1.05	1.10	1.15	1.20	1.25	1.25	2.00	9.00	1.0435	1.0338	39.89 36.97 38.430
WGL HOLDINGS, INC.	1.53	1.57	1.61	1.64	1.68	1.68	2.70	10.00	1.0228	1.0378	39.68 36.93 38.305

AVERAGE

1.7575

## S&P STOCK GUIDE: MAY 2011 with APRIL Stock Prices

Stock Price w/four Percent Flotation Costs	\$39.89	Annual	8.25%	ROE
Cash Flows	1.4019	1.2628	1.1982	33.5503
Present Value of Cash Flows	39.8875			

NOTE: The cash flows for this multi-stage DCF Model are derived using the average forecasted dividends and the near term and long term growth rates. The discount rate, 8.25%, equates the cash flows with the average stock price less flotation cost.

\$39.89 = April 2011 average stock price with a 4% flotation cost.

8.25% = Cost of equity required to match the current stock price with the expected cash flows.

Sources:

1. Stock Prices - S&P Stock Guide, May 2011, Edition.
2. DPS, EPS, ROE - Value Line Issue: March 11, 2011.

Capital Asset Pricing Model Cost of Equity for  
Water and Wastewater Industry

CAPM analysis formula

$$K = RF + \text{Beta}(\text{MR} - \text{RF})$$

$$K = \text{Investor's required rate of return}$$

$$\text{RF} = \text{Risk-free rate (Blue Chip forecast for Long-term Treasury bond, May 1, 2011)}$$

$$\text{Beta} = \text{Measure of industry-specific risk (Average for water utilities followed by Value Line)}$$

$$\text{MR} = \text{Market return (Value Line Investment Survey For Windows, May 2011)}$$

$$\underline{9.40\%} = 4.94\% + 0.67(11.28\% - 4.94\%) + 0.20\%$$

Note: We calculated the market return using a quarterly DCF model for a large number of dividend paying stocks followed by Value Line. For May 2011, the result was 11.28%. We also added 20 basis points to the CAPM result to allow for a four-percent flotation cost.

Attachment 1  
Page 5 of 6

BOND YIELD DIFFERENTIALS									
Public Utility Long Term Bond Yield Averages									
120 Month Average Spread		0.1424		0.1424		0.1424		0.1424	
MONTH/YEAR	A2	SPREAD	A3	SPREAD	Baa1	SPREAD	Baa2	SPREAD	Baa3
Mar-11	5.54	0.15	5.69	0.15	5.84	0.15	5.99	0.15	6.14
Sources: Moody's Credit Perspectives and Value Line Selection and Opinion									

INDEX STATISTICS AND FACTS

Natural Gas Distribution Proxy Group	S & P Bond Rating	% of Gas Revenue	V/L Market Capital (\$ millions)	Equity Ratio	Value Line Beta
AGL Resources Inc.	A-	63%	\$ 3,247.10	40.12%	0.75
Atmos Energy Corporation	BBB+	65%	\$ 3,102.80	48.58%	0.65
Laclede Group, Inc.	A	51%	\$ 862.82	54.30%	0.60
NICOR Inc.	AA	81%	\$ 2,541.71	54.45%	0.75
Northwest Natural Gas Co.	A+	94%	\$ 1,217.71	44.65%	0.60
Piedmont Natural Gas Co., Inc.	A	100%	\$ 2,280.01	49.77%	0.65
South Jersey Industries, Inc.	A	51%	\$ 1,702.11	44.81%	0.65
Southwest Gas Corporation	BBB	83%	\$ 1,784.55	47.49%	0.75
WGL Holdings, Inc.	AA-	49%	\$ 1,985.64	59.55%	0.65
Average:				49.30%	0.67
Sources:					

Value Line Investment Survey for Windows, May 2011  
S.E.C. Forms 10Q and 10K for Companies  
AUS Utility Report, May 2011

## **Exhibit 2 (LML-2)**

Shenck Island Utilities, Inc.  
Water and Wastewater Systems

Company Proposed						RPOC Proposed (Per Testimony of Item Under)						RPOC Proposed (Per Testimony of Item Under)					
Capital Structure and Rate of Return						Capital Structure and Rate of Return						Capital Structure and Rate of Return					
Capital	Ratio	Utility Rate Base	Embedded Cost Rate	Weighted Cost	Return	Capital	Ratio	Utility Rate Base	Embedded Cost Rate	Weighted Cost	Return	Capital	Ratio	Utility Rate Base	Embedded Cost Rate	Weighted Cost	Return
Debt	\$4,346,178	\$4,272,292 (1)	5.4500%	2.874%	\$447,530	Debt	\$4,346,178	\$4,272,292 (1)	5.4500%	2.874%	\$447,530	Debt	\$4,346,178	\$4,272,292 (1)	5.4500%	2.874%	\$447,530
Equity	\$2,212,858	\$2,104,092	11.1966%	6.117%	\$937,696	Equity	\$2,212,858	\$2,104,092	8.5000%	4.603%	\$254,689	Equity	\$2,212,858	\$2,104,092	10.6000%	4.513%	\$254,689
	\$15,561,036	\$15,376,383		9.09%	\$1,385,016		\$15,561,036	\$15,376,383		7.33%	\$1,332,419		\$15,561,036	\$15,376,383		7.89%	\$1,385,016
Revenue Requirement						Revenue Requirement						Revenue Requirement					
Equity Return						Equity Return						Equity Return					
Operating Margin						Operating Margin						Operating Margin					
Calculation of Operating Margin (PSC Method)						Calculation of Operating Margin (PSC Method)						Calculation of Operating Margin (PSC Method)					
\$6,818,135						\$6,818,135						\$6,818,135					
\$937,696						\$937,696						\$937,696					
13.75%						13.50%						11.50%					
Water						Water						Water					
Sewer						Sewer						Sewer					
Total						Total						Total					
\$15,376,383						\$15,376,383						\$15,376,383					

**Exhibit 3 (LML-3)**

Dowdell Island Utilities, Inc.  
Water and Wastewater Systems  
Comprehensive Water & Sewer Operating Statement

Company Proposed Statement of Operations and Revenue Breakdowns											
Year-End 12/31/2010	Test Year Adjustments	12/31/2010			12/31/2010			12/31/2010			
		Pro Forma Adjustments	Pro Forma Present Rates	Adjustments	Pro Forma Proposed Rates	Pro Forma Present Rates	Adjustments	Pro Forma Proposed Rates			
<b>Operating Revenue</b>											
Residential	\$ 3,564,058	\$ 108,155	\$ 3,672,213	\$ 647,851	60.907%	\$ 4,320,064	\$ 385,774	\$ 4,057,887	\$ 3,672,213	\$ 463,668	\$ 4,315,861
Commercial	\$ 399,880	\$ 5,614	\$ 405,494	\$ 70,251	6.004%	\$ 475,945	\$ 41,833	\$ 447,537	\$ 405,494	\$ 50,380	\$ 455,974
Hotel	\$ 116,332	\$ 1,367	\$ 117,719	\$ 18,483	1.788%	\$ 136,202	\$ 11,006	\$ 128,725	\$ 117,719	\$ 13,229	\$ 130,948
Golf Course	\$ 509,406	\$ (9,220)	\$ 500,186	\$ 86,339	8.117%	\$ 586,515	\$ 51,414	\$ 551,600	\$ 500,186	\$ 61,795	\$ 561,981
Irrigation	\$ 943,736	\$ 37,627	\$ 981,363	\$ 228,750	23.317%	\$ 1,208,113	\$ 135,026	\$ 1,116,549	\$ 981,363	\$ 162,290	\$ 1,143,633
Fire Service	\$ 49,260	\$ (2,022)	\$ 47,238	\$ 10,712	1.007%	\$ 57,950	\$ 6,379	\$ 53,817	\$ 47,238	\$ 7,667	\$ 54,905
Tap-In Revenue	\$ 47,250	\$ -	\$ -	\$ -	0.000%	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DHEC Reimbursement Fees	\$ 9,889	\$ -	\$ 9,889	\$ -	0.000%	\$ 9,889	\$ -	\$ 9,889	\$ 9,889	\$ -	\$ 9,889
Misc. Other Revenue	\$ 20,098	\$ -	\$ 20,098	\$ -	0.169%	\$ 23,784	\$ 2,002	\$ 22,424	\$ 20,098	\$ 2,406	\$ 22,818
Total Revenues	\$ 5,659,979	\$ 142,045	\$ 5,794,724	\$ 1,063,728	\$ 6,818,452	\$ 5,794,724	\$ 683,494	\$ 6,388,158	\$ 5,794,724	\$ 782,895	\$ 6,516,059
<b>Operating Expenses</b>											
O & M Expenses	\$ 3,903,807	\$ (47,250)	\$ 4,006,354	\$ 308	0.02895%	\$ 4,006,662	\$ 183	\$ 4,006,537	\$ 4,006,354	\$ 220	\$ 4,006,574
Depreciation	\$ 482,407	\$ 7,952	\$ 490,359	\$ -	\$ -	\$ 490,359	\$ -	\$ 490,359	\$ 490,359	\$ -	\$ 490,359
Amortization	\$ 25,402	\$ 52,135	\$ 77,537	\$ -	\$ -	\$ 77,537	\$ -	\$ 77,537	\$ 77,537	\$ -	\$ 77,537
Gross Receipts Tax	\$ 21,524	\$ 15,653	\$ 37,177	\$ 6,870	0.64584%	\$ 44,047	\$ 4,091	\$ 41,248	\$ 37,177	\$ 4,917	\$ 42,094
Property Taxes	\$ 227,654	\$ 2,638	\$ 230,292	\$ -	\$ -	\$ 230,292	\$ -	\$ 230,292	\$ 230,292	\$ -	\$ 230,292
Payroll Taxes	\$ 44,902	\$ 1,620	\$ 46,522	\$ -	\$ -	\$ 46,522	\$ -	\$ 46,522	\$ 46,522	\$ -	\$ 46,522
State and Federal Income Taxes	\$ 145,763	\$ 5,315	\$ 151,080	\$ 406,632	38.22707%	\$ 557,712	\$ 242,443	\$ 393,223	\$ 151,080	\$ 291,036	\$ 442,116
Total Operating Expenses	\$ 4,831,461	\$ 235,110	\$ 5,019,321	\$ 413,810	\$ 5,433,131	\$ 5,019,321	\$ 246,418	\$ 5,265,739	\$ 5,019,321	\$ 296,174	\$ 5,315,495
Net Operating Income	\$ 828,468	\$ -	\$ 775,403	\$ -	\$ 1,385,321	\$ 775,403	\$ -	\$ 1,122,420	\$ 775,403	\$ -	\$ 1,200,565
Rate Base	\$ 15,278,888	\$ -	\$ 15,326,381	\$ -	\$ 15,326,381	\$ 15,326,381	\$ -	\$ 15,326,381	\$ 15,326,381	\$ -	\$ 15,326,381
Rate of Return	5.42%		4.80%		9.04%			7.32%		4.80%	7.89%
Less: Interest		\$ -	\$ 447,530	\$ -	\$ 447,530	\$ 447,530	\$ -	\$ 447,530	\$ 447,530	\$ -	\$ 447,530
Operating Margin		\$ -	\$ 287,873	\$ -	\$ 937,791	\$ 287,873	\$ -	\$ 674,890	\$ 287,873	\$ -	\$ 753,005
<b>Determination of Revenue Increase Needed:</b>											
Proposed Operating Margin						\$ 447,530	Interest	\$ 447,530	Interest		\$ 447,530
Less: Present Operating Margin						\$ 937,791	Operating Margin	\$ 674,890	Operating Margin		\$ 523,084
Increase in Operating Margin Needed						13.75%	Operating Margin	23.96%	Operating Margin		\$ 11,586
Year Gross Up (1-(.94-(.06)))						18.5%	Revenue Increase	11.06%	Revenue Increase		\$ 750,084
Revenue Increase Needed						\$ 1,041,790					\$ 518,873
											\$ 463,161
											\$ 610,098
											\$ 776,185



**Exhibit 4 (LML-4)**

**Elmwood Island Utilities, Inc.**  
**Water and Wastewater Systems**

<b>Company Proposed</b>									
<b>Capital Structure and Rate of Return</b>									
Capital	Ratio	Utility Rate Base	Included Cost Rate	Weighted Cost	Return	Capital	Ratio	Utility Rate Base	Weighted Cost
Debt \$ 8,348,178	53.65%	\$ 8,272,292 (1)	5.4500%	2.934%	\$ 447,130	Debt \$ 8,348,178	53.65%	\$ 4,961,274 (1)	5.4500%
Equity \$ 7,212,858	46.35%	\$ 7,104,292	13.8566%	6.117%	\$ 937,896	Equity \$ 7,212,858	46.35%	\$ 4,268,560	18.6800%
\$ 15,561,036	100.00%	\$ 15,376,583		9.54%	\$ 1,385,026	\$ 15,561,036	100.00%	\$ 9,229,834	
<b>Revenue Requirement</b> <b>Equity Return</b> <b>Operating Margin</b>						<b>Calculation of Operating Margin (PSC Method)</b> Revenue Requirement \$6,818,155 Equity Return 5937,896 Operating Margin 33.75%			
Water		\$ 9,062,848				Water		\$ 5,482,038	
Sewer		\$ 6,382,536				Sewer		\$ 3,785,796	
Total		\$ 15,445,383				Total		\$ 9,267,834	

<b>EPSC Proposed (Per Testimony of Lynn Lashley)</b>									
<b>Capital Structure and Rate of Return</b>									
Capital	Ratio	Utility Rate Base	Included Cost Rate	Weighted Cost	Return	Capital	Ratio	Utility Rate Base	Weighted Cost
Debt \$ 8,348,178	53.65%	\$ 4,961,274 (1)	5.4500%	2.934%	\$ 270,389	Debt \$ 8,348,178	53.65%	\$ 4,961,274 (1)	5.4500%
Equity \$ 7,212,858	46.35%	\$ 4,268,560	9.8800%	4.403%	\$ 467,220	Equity \$ 7,212,858	46.35%	\$ 4,268,560	18.6800%
\$ 15,561,036	100.00%	\$ 9,229,834		7.839%	\$ 677,609	\$ 15,561,036	100.00%	\$ 9,229,834	
<b>Revenue Requirement</b> <b>Equity Return</b> <b>Operating Margin</b>						<b>Calculation of Operating Margin (PSC Method)</b> Revenue Requirement \$5,660,189 Equity Return \$467,220 Operating Margin 7.19%			
Water		\$ 5,482,038				Water		\$ 5,482,038	
Sewer		\$ 3,785,796				Sewer		\$ 3,785,796	
Total		\$ 9,267,834				Total		\$ 9,267,834	

<b>EPSC Proposed (Per Testimony of Lynn Lashley)</b>									
<b>Capital Structure and Rate of Return</b>									
Capital	Ratio	Utility Rate Base	Included Cost Rate	Weighted Cost	Return	Capital	Ratio	Utility Rate Base	Weighted Cost
Debt \$ 8,348,178	53.65%	\$ 4,961,274 (1)	5.4500%	2.934%	\$ 270,389	Debt \$ 8,348,178	53.65%	\$ 4,961,274 (1)	5.4500%
Equity \$ 7,212,858	46.35%	\$ 4,268,560	18.6800%	4.403%	\$ 467,220	Equity \$ 7,212,858	46.35%	\$ 4,268,560	18.6800%
\$ 15,561,036	100.00%	\$ 9,229,834		7.839%	\$ 677,609	\$ 15,561,036	100.00%	\$ 9,229,834	
<b>Revenue Requirement</b> <b>Equity Return</b> <b>Operating Margin</b>						<b>Calculation of Operating Margin (PSC Method)</b> Revenue Requirement \$5,792,312 Equity Return \$ 494,178 Operating Margin 7.80%			
Water		\$ 5,482,038				Water		\$ 5,482,038	
Sewer		\$ 3,785,796				Sewer		\$ 3,785,796	
Total		\$ 9,267,834				Total		\$ 9,267,834	

**Exhibit (LML-5)**

**Company Proposed**

**Statement of Operations and Balance Sheet**

[illegible]

1 **KIAWAH ISLAND UTILITY, INC.**

2  
3 **DOCKET NO. 2011-317-WS**

4  
5 **PRE-FILED TESTIMONY OF WILLIAM D. ROGERS**

6  
7 **BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

8  
9 **Testimony Prepared: November 16, 2011**

10  
11 **Hearing Date: November 30, 2011**

12  
13 **THIS TESTIMONY IS FILED PURSUANT TO PSC LETTER DATED AUGUST 15,**  
14 **2011. THE INTERVENOR RESERVES THE RIGHT TO PROVIDE ADDITIONAL**  
15 **TESTIMONY CONCERNING FURTHER INTERROGATORY REPSONSES AND**  
16 **REBUTTAL TESTIMONY TO BE PRE-FILED PURSUANT TO SAID ORDER, BY THE**  
17 **APPLICANT AND/OR ANY OTHER PARTY TO THIS PROCEEDING.**

18 **MR. MOLONY: PLEASE STATE YOUR NAME, EMPLOYER AND BUSINESS**  
19 **ADDRESS.**

20 **MR. ROGERS:** My name is William D. Rogers and I am employed by American Water Works  
21 Service Company (the "Service Company"), a subsidiary of American Water Works Corporation  
22 ("AWW"). I am the Vice President and Treasurer of AWW. My business address is 1025 Laurel  
23 Oak Road, Voorhees, New Jersey 08043.

24 **MR. MOLONY: PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND:**

25 **MR. ROGERS:** I hold an MBA in accounting and finance from Duke University. I am also a  
26 distinguished graduate of the U.S. Military Academy with a bachelor's degree in engineering and  
27 economics. Before beginning my finance career, I served on active duty as an engineer and  
28 officer in the United States Army for six years, departing with the rank of captain.

1 **MR. MOLONY: PLEASE SUMMARIZE YOUR WORK EXPERIENCE.**

2 **MR. ROGERS:** Prior to joining AWW in 2010, I was the chief financial officer for NV Energy,  
3 an investor-owned utility in Las Vegas serving 1.5 million electric and gas customers, with  
4 annual revenues of \$3.3 billion. I previously served as vice president of finance, risk and tax, as  
5 well as corporate treasurer. Before joining NV Energy, I was a managing director of capital  
6 markets for both Merrill Lynch and JPMorgan Chase in New York. I have testified in numerous  
7 utility rate proceedings in various jurisdictions.

8 **MR. MOLONY: WHAT IS THE PURPOSE OF FILING A RATE INCREASE**  
9 **APPLICATION EVERY 2-3 YEARS?**

10 **MR. ROGERS:** The purpose is if there are circumstances that warrant an increase, then by filing  
11 for a rate increase every 2-3 years you avoid what in utility parlance is called “rate shock” which  
12 I believe is the situation with the current rate increase application, since it has been 10 years  
13 since the last rate increase.

14 **MR. MOLONY: WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

15 **MR. ROGERS:** I have been asked to review the rate increase application of Kiawah Island  
16 Utility (“KIU”) as submitted and comment on the filing from the perspective of investor-owned  
17 water utilities.

18 **MR. MOLONY: WHAT IS YOUR OPINION OF THE PROPOSED RATE INCREASE**  
19 **APPLICATION SUBMITTED BY KIU?**

20 **MR. ROGERS:** First of all, it is lacking a great deal of important information the Commission  
21 or staff should have with respect to developing a reasoned, objective decision. As an example,

1 the application does not contain audited financial statements. These were obtained during  
2 discovery and reveal that at least three significant related party transactions took place in 2008,  
3 2009 and 2010. KIU purchased land parcels from its parent, Kiawah Resort Associates (“KRA”)  
4 for a total of \$5.1 million.

5 **MR. MOLONY: IN YOUR PROFESSIONAL OPINION, WHAT IS THE**  
6 **APPROPRIATE BASIS FOR DETERMINING THE ALLOWED PROFIT OR RETURN**  
7 **TO A UTILITY.**

8 **MR. ROGERS:** In my professional opinion, the most appropriate and most widely used  
9 approach is “Return on Rate Base” and the “Return on Equity” portion of this calculation.

10 **MR. MOLONY: WHAT IS A BENCHMARK YOUR COMPANY USES IN ASSESSING**  
11 **AN APPROPRIATE RETURN ON EQUITY?**

12 **MR. ROGERS:** Return on Investment, Return on Rate Base, Return on Equity or even using an  
13 operating margin approach is a function of the risk for that investment. In its filing, KIU appears  
14 to be requesting a Return on Rate Base of over 9.0% and a Return on Equity of almost 13.2%.  
15 Since KIU has relatively low operating risk as a regulated utility, it would be deemed a very safe,  
16 low risk investment. In the current and foreseeable economic environment, it would be very  
17 difficult to earn a return of more than 13%, particularly on a relatively risk free investment. In  
18 fact, with treasury rates where they are currently, the spread between the Return on Equity the  
19 utility is requesting and what could be obtained with a comparable low risk investment, is far in  
20 excess of what would be expected. In my view, a more appropriate Return on Equity to be

1 expected would be in the range of 10%, which is what I have observed from recent rate case  
2 decisions.

3 **MR. MOLONY: IN YOUR OPINION, DOES THE REVENUE REQUIREMENT**  
4 **PROPOSED BY KIU INCLUDE ONLY THE COSTS ASSOCIATED WITH THE**  
5 **PROVISION OF WATER AND SEWER SERVICE?**

6 **MR. ROGERS:** First and foremost, I have a major concern with the lack of arms-length  
7 negotiations of expenses. For example, the original estimate of the water line extension was  
8 understated. Other examples are the lack of supported detail on management fees and  
9 justification for how they are calculated. An additional concern pertains to the payments for land  
10 acquired by or leased to the utility by KRA. Additionally, payments for construction expenses to  
11 their affiliate, Gulfstream Construction Company, should be closely scrutinized because those  
12 projects/expenses were not put out to bid. So it appears to me that the costs are not only those  
13 associated with the provision of water and sewer service but also the cost of purchasing land  
14 from the parent organization and the cost of certain construction services provided by the parent,  
15 which may not have been in the best interests of the utility or its rate payers.

16 **MR. MOLONY: WHAT WOULD YOUR CONCERNS BE WITH RESPECT TO THE**  
17 **EVALUATION OF A DEVELOPER-OWNED UTILITY?**

18 **MR. ROGERS:** In my opinion, there is simply too much temptation to operate the utility for  
19 the benefit of the developer. For example, it is common practice in the water and sewer utility  
20 industry for developers to pay most, if not all, the cost of water and/or sewer extensions, but  
21 according to KIU's responses to interrogatories, it appears that KIU is not charging developers,  
22 particularly KRA, for line extensions and upgrades to provide service to new areas. This seems



1 to be very much in the best interest of KRA but the impact is that the investments made by KIU  
2 for such extensions, ends up in the rate base to be paid for through customer rates. A good deal  
3 if you can get it, but it does not seem to be in the best public interest.

4 **MR. MOLONY: BASED ON THE PROJECTS YOUR COMPANY IS INVOLVED IN,**  
5 **WHAT IS A NORMAL OPERATING MARGIN?**

6 **MR. ROGERS:** Our Company looks at return on equity. For our projects, in the current  
7 environment, the return on equity would be in the range of 10.5% -11.5%. This rate of return is  
8 appropriate for our investors. Our investments tend to be more complex than a developer-owned  
9 system. Therefore, investors in a developer-owned system should expect a lower return on  
10 equity. With a developer-owned system there are numerous indirect returns to the parent  
11 company in the form of management fees, building incentive fees (availability fees), lack of  
12 impact fees paid for development with costs being recovered through the sale of lots, and  
13 payments for utility assets that would normally be donated to an investor-owned utility. My  
14 experience would lead me to the conclusion that an operating margin for a developer-owned  
15 utility should be much lower than for investor-owned utilities. Using the average operating  
16 margin that the PSC has historically granted this utility, I believe something in the range of 7%  
17 would be reasonable in order to achieve their appropriate return on equity.

18 **MR. MOLONY: SO, IN YOUR OPINION, THE 13.75% OPERATING MARGIN**  
19 **REQUESTED IN THE APPLICATION IS NOT REASONABLE FOR KIU'S WATER**  
20 **AND SEWER OPERATIONS ON A COMBINED BASIS?**

21 **MR. ROGERS:** That it is correct. I believe 7% is a more reasonable operating margin request.  
22 13.75%, which translates into a 13.2% Return on Equity, seems to be excessive.

1 **MR. MOLONY: WHAT ABOUT THE IMPACT OF CUSTOMER GROWTH?**

2 **MR. ROGERS:** Since the PSC uses a test year approach, growth is limited to this one year.  
3 However, if you look at the fact that expense for sewer rates (and the rate increase requested) has  
4 been minimal, that indicates that there has been a substantial increase in the customer base which  
5 should have an effect on minimizing overall rate needs. It is appropriate to recognize that  
6 increases in customers and increases in customer usage is an advantage for a utility in which the  
7 revenue requirement is calculated on a historic test year basis.

8 **MR. MOLONY: IS IT USUAL FOR DEVELOPERS TO CHARGE UTILITIES FOR**  
9 **INFRASTRUCTURE AND/OR LAND ON WHICH UTILITY PROPERTY IS**  
10 **LOCATED?**

11 **MR. ROGERS:** No. In fact, it is highly unusual. As has been cited in this case, the same  
12 developer that owns the Applicant was required to pay 2.1 million dollars for infrastructure put  
13 into place to service a golf course development (Cassique) and a commercial development  
14 (Freshfields) which was donated at no cost to an independent utility provider.

15 **MR. MOLONY: HAVE YOU READ THE APPLICATION WITH RESPECT TO THE**  
16 **ALLEGED PURPOSE OF THE LOANS AT RBC?**

17 **MR. ROGERS:** I have and I do not believe the loans are related to the acquisition of capital  
18 items as referenced in the testimony of one of the witnesses.

19 **MR. MOLONY: CAN YOU EXPLAIN THAT?**

20 **MR. ROGERS:** Yes. Each of these loans clearly benefited the Developer, but serves no public  
21 benefit since the utility plant was already on-site, lease payments had been made over a course of

1 years to the Developer, whose Directors also serve as Directors of the Utility and who simply  
2 paid themselves for items that either should have been donated or they already owned. As a  
3 result of these transactions, the utility transferred funds to the parent for assets that should have  
4 been donated to the utility or for assets already owned by the utility.

5 **MR. MOLONY: WHAT IS THE EFFECT OF THESE TRANSACTIONS ON THE**  
6 **UTILITY?**

7 **MR. ROGERS:** First, it drains the Utility of cash. In this case, \$5.1 million was transferred to  
8 the parent. Second, since the money was borrowed to purchase the land, it obligates the Utility  
9 to repay these debts which diminishes its borrowing capacity and, of course, increases interest  
10 costs and affects its ability to provide adequate financing for its public utility operations. Third,  
11 it provides a disguised dividend to its parent company, which the Commission has not reviewed.  
12 It certainly appears that under the Commission rules (specifically the §103-854) these  
13 transactions should have been reviewed and approved by the Commission prior to their  
14 execution.

15 **MR. MOLONY: HOW COULD THE COMMISSION ADDRESS THESE**  
16 **TRANSACTIONS IN THIS RATE PROCEEDING?**

17 **MR. ROGERS:** First, the Commission could simply reverse them. Clearly, the Commission  
18 has jurisdiction over the Utility and it could order the Utility to repay these obligations to the  
19 bank, transfer the property back to the parent and eliminate the items from its balance sheet.  
20 Second, the Commission could consider these as dividends which were paid to the parent. Third,  
21 the Commission could take each of these items and deduct them as a contribution to initiate in  
22 the aid of construction which would result in a \$5.1 million reduction in rate base. This was

1 similar to the action taken by the Commission when the Utility engaged in an earlier transaction  
2 relating to \$1.9 million of utility assets.

3 **MR. MOLONY: WHAT EFFECT DOES EACH OF THESE METHODS HAVE ON THE**  
4 **UTILITY IN THIS APPLICATION?**

5 **MR. ROGERS:** The first involving repayment would clearly eliminate the debt from the  
6 Utility's books, reducing the need for any rate increase. The second would recognize the actual  
7 financial nature of the transaction and result in an unbelievably high rate of return thus  
8 compelling the Commission to deny this particular increase. The third would result in a reduced  
9 capital item and therefore, affect the financial statement by reducing the total revenue needed to  
10 the possibility to the point where there is no rate increase needed.

11 **MR. MOLONY: IS THERE ANYTHING ELSE YOU WOULD LIKE TO ADD**  
12 **REGARDING THE KIU RATE INCREASE APPLICATION?**

13 **MR. ROGERS:** No.

14 **MR. MOLONY: DOES THIS CONCLUDE YOUR TESTIMONY?**

15 **MR. ROGERS:** Yes, it does.

16 **END OF DIRECT TESTIMONY**